FORECAST 1992-1993

First Interstate Territory Edition

First Interstate Bancorp

FIRST INTERSTATE BANCORP

BANKING AFFILIATES

California
First Interstate Bank of California
First Interstate Bank, Limited

Northwest
Alaska
First Interstate Bank of Alaska, N.A.

Idaho
First Interstate Bank of Idaho, N.A.

Montana
First Interstate Bank of Montana, N.A.

Oregon
First Interstate Bank of Oregon, N.A.

Washington
First Interstate Bank of Washington, N.A.

Southwest
Arizona
First Interstate Bank of Arizona, N.A.

Colorado
First Interstate Banks of Denver, N.A., and Englewood, N.A.

Nevada
First Interstate Bank of Nevada, N.A.

New Mexico
First Interstate Bank of Santa Fe, N.A.

Utah
First Interstate Bank of Utah, N.A.

Wyoming
First Interstate Bank of Wyoming, N.A.

Texas
First Interstate Bank of Jacksonville
First Interstate Bank of Texas, N.A.

BANK LICENSEES

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First Interstate Banks of Arvada, N.A., Centennial, N.A., Golden, N.A., Westminster, N.A.,
First Interstate Bank of South Fort Collins
First Interstate Bank of Fort Collins, N.A.

Hawaii
First Interstate Bank of Hawaii

Iowa
First Interstate of Iowa, Inc.

Louisiana
First Interstate Bank of Southern Louisiana

Montana
First Interstate Banks of Billings, N.A., Billings Heights, Colstrip, Hardin, Miles City, Missoula, N.A., and West Billings

North Dakota
First Interstate Bank of Fargo, N.A.

South Dakota
First Interstate Bank of South Dakota, N.A.

Wyoming
First Interstate Bank of Commerce

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Bangkok
Beijing
Hong Kong
Jakarta
Lima
London
Manila
Mexico City
Rio de Janeiro
Seoul
Shanghai
Singapore
Sydney
Taipei
Tokyo
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Overview

The ending of both the recent hot war with Iraq and the long-term cold war with the Soviet Union radically alters the public policy agenda for the final years of the century. While the dramatic developments around the world dominated national news stories for the past two years, "neighborhood" issues such as drug usage, street crime, traffic jams, poor schools, crowded prisons, the homeless, waste disposal, and unemployment seemed almost mundane by comparison.

Expanding Horizons

The focus on the international political developments--from the liberation of Eastern Europe in 1989 to the crumbling of communism and the Soviet Empire in 1991--will now give way to increasing attention to domestic economic and political issues. A less threatening and confrontational global environment will permit both the attention of policymakers and the nation's economic resources to be redirected toward persistent domestic problems.

Eight years of economic growth in the 1980s ended with the third Middle East oil shock in two decades. A number of factors, including the quick and decisive defeat of Iraq, suggest that the Middle East will not produce another oil shock in the next few years. Monetary policy also has become less destabilizing. These trends suggest that the fluctuations of inflation and interest rates, as well as of output and employment growth, will be much smaller than in recent decades. Less volatility means that business decision makers will have less uncertainty about the future than at any time in several decades. The resulting lower "hurdle rates" for investment decisions will foster better trends of capital formation, productivity, and real income gains.

Diversity Amidst Recovery

The narrower corridor in the variability of major national economic indicators will obscure considerable diversity of performance among the major sectors and industries of the economy. Some regions that were strong during the recovery from the 1981-82 recession--such as New England--are expected to trail the national expansion. Other regions that were weak in the previous recovery--mainly the Southwest and the Rocky Mountain states--will outperform the nation as a whole.

Similarly, industries such as defense and commercial construction that were vigorous during most of the 1980s will remain depressed in the expansion of the 1990s. Meanwhile, basic manufacturing "smokestack" industries are expected to be stronger in this expansion, in contrast to the weak performance of the 1980s recovery.

Slower growth of the working-age population in the past decade means that far fewer **jobs** will need to be created in the 1990s expansion in order to lower the **unemployment** rate. It also means much slower growth in

Contents

Overview 1
The U.S. Economy 3
Industry Perspective 9
Financial Institutions 12
The International Economy 15
First Interstate Territory 21

entry level housing, but a greater need for schools as the baby-boom "echo" builds.

The aging of the "baby-boom generation" will be reflected in faster growth of real per capita **personal income** and higher **saving** rates. Several "superior-goods industries" will be the main beneficiaries of these major demographic trends. Employment growth in **health-care** fields will continue to be rapid, as it will in the leisure group of industries--recreation, travel, tourism, and entertainment.

As national attention turns away from foreign confrontation, more resources will be used to provide **security** in our neighborhoods and city streets. The problems of drug usage and the associated violence will move to a higher priority on the public policy agenda. The demands on police, courts, and correction facilities will rise correspondingly.

A broad spectrum of industries also will be affected by growing concerns over the **environment**. From heavy construction projects to recycling and trash disposal facilities, the challenge will be to find private-sector financing to meet the growing demands for less pollution.

The U.S. financial sector is going through its most difficult restructuring since the Great Depression of the 1930s. Then, the response to financial fragility was segmentation of the industry and increased involvement of government in a "permission and denial" regulatory environment. Now, a rocky transition is being made toward a less regulated, more competitive national system involving an "information and disclosure" supervisory environment. In the end, financial institutions will be more resilient and stable.

In the early years of recovery from the 1981-82 recession, the value of the U.S. dollar rose sharply relative to other major currencies, rendering much of U.S. **manufacturing** noncompetitive on world markets. The resulting trade deficit reflected both strong import growth and weakness in exports.

As the expansion of the 1990s gets under way, the dollar is at a level that leaves U.S. **exporting** and **import-competing** industries much more competitive. The strong improvement in manufacturing **productivity** during the eight-year expansion held unit labor costs of manufacturing flat between 1982 and 1990. This achievement will help sustain export growth in the 1990s, while U.S. manufacturers also will recapture domestic markets from foreign producers.

In the expansion of the 1980s, **defense spending** consumed a growing share of the nation's resources; in the 1990s that trend is being reversed. Those industries and regions of the country that benefited from a growing defense sector are now challenged by the necessity to diversify into non-defense production.

Construction resources in the 1980s were used to house the baby-boom generation and to build a large inventory of office, hotel, and shopping space. Now, the demand will be for infrastructure projects, including transportation, education, water, trash and sewage disposal, pollution abatement, penal institutions, and health-care facilities. The challenge will be to provide adequate funding and private-sector incentives to address these areas, especially in view of the budgetary constraints on the public sector.

Sustained Disinflation

The pressures created by the disinflationary trend of the late 1980s can be expected to continue in 1992-93. The adverse effects on asset prices--especially in the real estate sector--will hamper production and construction. The benefits to the economy in terms of more stable purchasing power of money and lower interest rates will gradually build.

The 1990s began with a recession, a pattern that has been repeated during each of the past three decades. Compared with other economic downturns since World War II, however, the latest contraction was relatively mild. Real GNP declined a total of 1.1%--about half the postwar average drop of 2.3%. The economy is now likely to experience a period of more stable growth with lower inflation and lower interest rates.

Expansion of the 1990s--Dominant Forces

Four major forces will influence the economy's direction during the next two years: monetary policy, fiscal policy, demographics, and oil prices.

Monetary Policy--Keys to the Safe

To accommodate the recovery following the Gulf war, the Federal Reserve set its 1991 growth target for M2 (currency, checking & savings accounts, and small certificates of deposit) at 2.5-6.5%. M2 growth was quite rapid early in 1991, and the Fed was apparently aiming at the upper half of its target range. Money growth stalled around the middle of the year, however, and by August this measure of the money supply was barely above its lower target bound.

Over the long run, nominal GNP tends to grow at about the same pace as M2. Over short periods of time, GNP gains can outstrip M2 increases, although such situations are generally characterized by rising interest rates, in contrast to the falling rates of 1991. The Fed could take some solace in the sizable growth of M1 (currency and checkable deposits), which by August had recorded an annual growth of 7.0% measured from 1990's fourth quarter. The steepness of the yield curve also appeared to be encouraging investors to move out of bank CDs into stock and bond funds not included in M2.

The weakness of M2 growth, nevertheless, represented the greatest risk of a "double-dip" recession. The poor performance of employment and income in the middle of 1991 indicated that even if M2 were overstating the tightness of monetary policy, more rapid money growth would be necessary to prevent the incipient recovery from being snuffed out.

Our forecast is based on the assumption that money growth revives by the end of 1991, with M2 growth of 5.5% occurring in 1992. As the Fed pursues its long-term goal of quashing inflation, M2 growth is likely to moderate to about 4.7% in 1993.

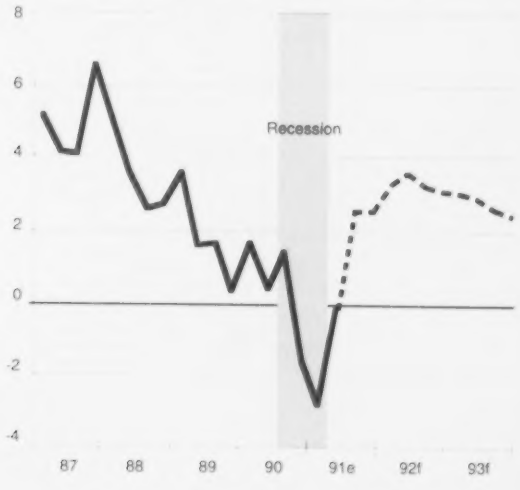
Fiscal Policy--Red Ink Persists

Little near-term change is anticipated in U.S. fiscal policy, despite demands to address domestic priorities, requests to aid the Soviet Union, lingering effects of the recession, and a presidential election in 1992.

The budget agreement reached in 1990 (the Omnibus Budget Reconciliation Act or OBRA) established individual spending caps for three categories of "discretionary spending"--defense, international, and domestic--for fiscal years 1991, 1992, and 1993.

Real GNP Recovers

(Percent change from prior quarter, annual rate)



"Mandatory" (required by law) benefit programs were set on a "pay-as-you-go basis." One program's outlays could be raised only if another's were cut or if taxes were increased.

The jury is still out as to the success of OBRA in restraining the deficit. Certain loopholes appear to have allowed spending limits to be overshot, but the new budget process has still imposed some discipline on congressional actions.

The deficit for fiscal 1991 (which ended September 30) was an estimated $282 billion, compared with 1990's spending-revenue gap of $220 billion. We expect the 1992 deficit to balloon to about $375 billion before it is reduced to about $294 billion in 1993.

Three major factors are causing the near-term escalation in the deficit. Delays in dealing with the S&L debacle have pushed deposit insurance expenditures from 1991 into 1992. Allied contributions for operation Desert Storm held down 1991's deficit, while some replacement-part spending for equipment damaged or destroyed during the Gulf war will add to 1992's outlays. The recession also dampened tax revenue while raising required spending for such programs as unemployment compensation.

The Federal Reserve is unlikely to accommodate these large deficits through rapid monetary growth because of the concern about inflation. As private credit demands begin to pick up in late 1992 or 1993, greater potential will exist for "crowding" out of consumer or business borrowing.

Demographics--A Generation of 'Grumpies"

The "baby boomers" born between 1946 and 1964 are gradually changing in the eyes of marketers from "yuppies" (young upwardly-mobile professionals) to "grumpies" (grown-up mature professionals). Census numbers show that this 26-44 age group accounted for nearly a third of the total population in 1990.

Trends of the baby-boom generation have heavily influenced economic events during the past three to four decades. The strong gains during the 1980s in consumer spending and housing investment were in significant part driven by this population segment. This group is now likely to save at higher rates for several reasons: provision for their own retirement, smaller tax benefits from interest expense, and lower inflation.

Demographic trends in the near term should be relatively favorable for the economy by fostering greater saving and investment. The next major demographic challenge will occur in the next century when the first of the baby boom generation begins to retire.

Other demographic features will have important effects on the near-term outlook. The number of new young adults has dropped dramatically because of the "baby bust" of twenty years ago. At the same time, the annual number of new births has recently jumped back to the levels of the mid 1960s. Immigration from Latin America and Asia will also continue to have important effects on the U.S. economy.

Oil Prices--Moderate

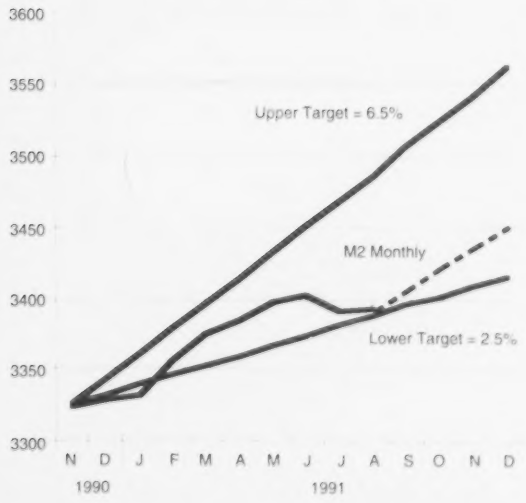
Oil prices, in terms of the West Texas Intermediate benchmark, are likely to average slightly over $21 a barrel in 1991. We assume that prices will generally average in the $20-$21 a barrel range during 1992 and 1993. Winter heating demand could put upward pressure on prices late in 1991, and stronger industrial-country growth could lead to a firming in worldwide demand in 1992. At the same time, however, the gradual restoration of Kuwaiti and Iraqi supplies will limit any upward pressure on prices, as will continued sizable production by Saudi Arabia.

Economic Climate To Turn Positive

The U.S. recession, which began in 1990's third quarter, appears to have

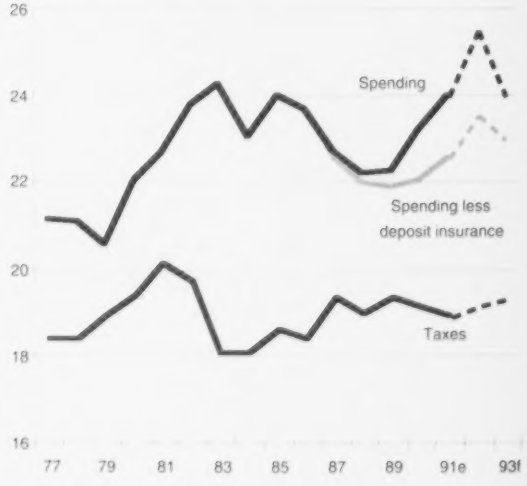
M2--Near Lower 1991 Target

(Billions of dollars, monthly average)



Federal Deficit Worsens in Near Term

(Spending and taxes as percent of GNP, fiscal year)



ended in the second quarter of 1991. We expect real GNP growth to average about 2.6% in 1991's second half after the 2.8% annualized decline in the first quarter and a virtually flat performance in the second quarter.

Our forecast is for substantial economic improvement in 1992, with a 3.4% real GNP gain. Gradual tightening by the Federal Reserve in 1993 because of inflation concerns is likely to temper that year's growth to 2.8%.

Just as the recession was comparatively mild, the recovery will be moderate by historical standards. The average first-year rise in real GNP in the recoveries since World War II was 6.7%. We expect growth in the first year of the current recovery to be 3.1%.

Opportunities and Risks

Consumer spending will grow moderately in the new expansion. Both demographic forces and the accumulation of debt by households during the 1980s will restrain spending. Income gains should improve, however, with a resumption of employment growth and increases in wages and salaries that exceed the rise in consumer prices. The advances in stock and bond prices which have taken place, together with at least a stabilization of real estate prices, have also bolstered the net worth of many individuals.

Home sales will continue to improve with stronger consumer confidence and lower interest rates. After plunging to only 1.04 million units in 1991, we expect housing starts to rise to 1.28 million units in 1992 and 1.38 million in 1993. The single-family market will return to healthier levels relatively quickly. National apartment vacancy rates remain high and are preventing a recovery in the multi-family sector. Lower vacancy rates, rising rents, and better returns may develop by the end of 1992, leading to more multi-family housing construction in 1993.

Business firms will continue to rebuild inventories over the next several months, which should give a sizable boost to economic activity. Companies will also raise capital spending plans as efforts continue to bolster productivity. Outlays for business equipment are likely to rise at a real rate of about 6% over the course of 1992 and 5% during 1993.

Direct government spending will be restrained by fiscal problems at local, state, and federal levels. Defense cuts are likely to be accelerated, with contracts based on defense against the Soviets shelved or scaled back. Construction of roads, other transportation facilities, schools, and prisons will remain strong because of funding by specially-earmarked tax revenues or by bond financing.

Nonresidential construction will remain the weakest economic sector of the national economy through 1993 because of excess capacity in hotels, office buildings, and shopping centers. Most of the commercial construction work will involve completion of projects previously started or renovation of older structures.

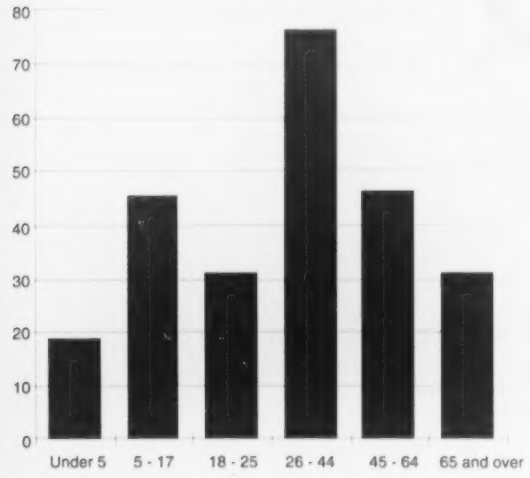
Brighter Outlook--Jobs and Profits

Nearly 22 million jobs were created in the expansion that ended in July 1990. Manufacturing employment had started to shrink early in 1989, and weakness eventually spread to nearly all other major economic sectors. Only health care appears to have escaped the impact of layoffs.

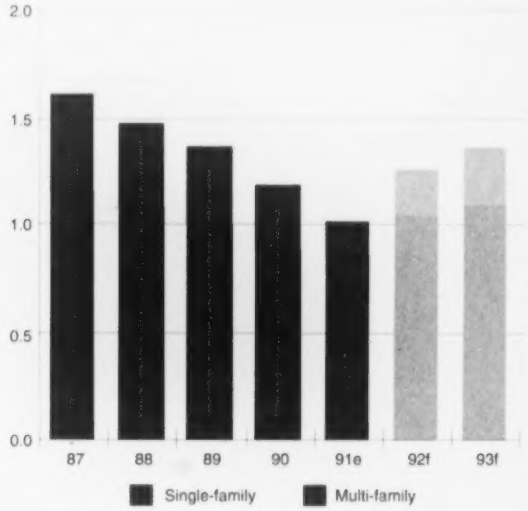
We expect modest job growth in the final months of 1991, with moderate gains continuing in 1992 and 1993. Employment growth will trail advances in output as industries throughout the economy, especially in the broad services sector, strive to enhance productivity. Our forecast indicates a rise of 2.0 million jobs on nonfarm payrolls in both 1992 and 1993 (measured fourth quarter to fourth quarter). The year 1991 will show a loss of about 800,000 jobs.

The unemployment rate reached a peak of 7.0% in mid 1991 and is likely to remain relatively high for the first

More Baby Boomers Reach 40
(1990, U.S. population by age, millions)



Housing Starts Gradually Improve
(Millions of units)



few months of the recovery until hiring begins to pick up. We expect the jobless rate to ease to 6.2% by the end of 1992 and 5.5% by December 1993. A significant reduction in the jobless rate will be achievable even with moderate job gains because of relatively sluggish growth of the labor force. The working-age population (16 and over) is currently rising by less than 1% per year and, after climbing substantially during the past two decades, the labor-force participation rate is likely to be relatively stable.

Corporate profits have borne much of the brunt of the latest recession. We focus on "economic" after-tax profits, which value depreciation on a replacement-cost basis and exclude inventory gains. This profit measure dropped sharply during the past two years, before edging up an estimated 2% in 1991.

Corporate profits should rebound by about 8% in 1992, followed by another 7% climb in 1993. The ability of most firms to raise prices aggressively will be limited during the next two years by a lower inflation environment and a generally moderate growth of sales. A lower level of interest rates compared with that of recent years, however, will help restrain financing costs. Many firms have also lowered their break-even points by cutting

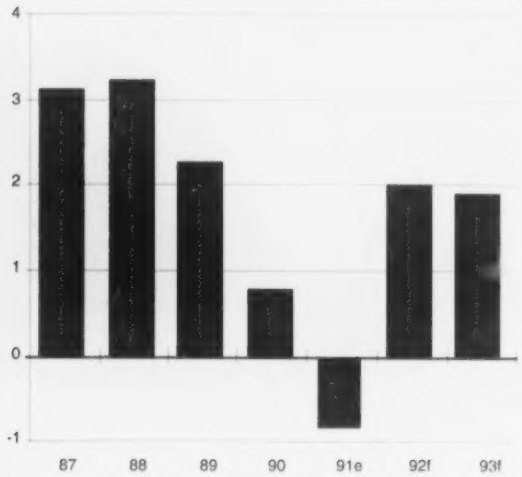
MAJOR ECONOMIC INDICATORS

	Quarterly 1991 I	1991 II	1991 III	1991 IV	1992 I	1992 II	1992 III	1992 IV
	Actual				Forecast			
GROSS NATIONAL PRODUCT (Billions of $, annual rate)	5557.7	5615.8	5680.7	5754.5	5848.5	5948.3	6045.5	6141.5
% Change, annual rate	2.2	4.2	4.7	5.3	6.7	7.0	6.7	6.5
REAL GNP (Billions of 1982 $, a.r.)	4124.1	4123.0	4149.2	4176.2	4211.2	4249.4	4284.0	4317.8
% Change, annual rate	-2.8	-0.1	2.6	2.6	3.4	3.7	3.3	3.2
REAL FINAL DOMESTIC SALES* (Billions of 1982 $, a.r.)	4143.6	4158.5	4169.7	4181.7	4211.1	4245.6	4276.0	4305.3
% Change, annual rate	-4.5	1.4	1.1	1.2	2.8	3.3	2.9	2.8
REAL CHANGE IN INVENTORIES (Billions of 1982 $, a.r.)	-25.0	-27.7	-12.5	4.0	10.0	14.0	17.0	20.0
GNP DEFLATOR (1982=100)	134.8	136.2	136.9	137.8	138.9	140.0	141.1	142.2
% Change, annual rate	5.2	4.2	2.1	2.6	3.2	3.2	3.3	3.2
CONSUMER PRICE INDEX (1982-84=100)	135.0	135.7	136.7	137.9	139.1	140.3	141.6	142.8
% Change, annual rate	3.6	2.1	3.0	3.6	3.6	3.5	3.6	3.4
AUTO SALES (Millions, annual rate)	8.2	8.5	8.9	9.3	9.4	9.6	9.7	9.8
HOUSING STARTS (Millions, annual rate)	0.92	1.00	1.11	1.16	1.19	1.26	1.32	1.35
INDUSTRIAL PRODUCTION (1987=100)	105.8	106.3	107.9	108.7	109.8	111.0	112.2	113.3
% Change, annual rate	-9.6	1.9	6.2	3.0	4.0	4.5	4.3	4.0
NONFARM EMPLOYMENT (Millions)	109.2	108.8	108.8	109.0	109.3	109.8	110.4	111.0
UNEMPLOYMENT RATE (Percent)	6.5	6.8	6.8	6.9	6.8	6.7	6.5	6.3
ECONOMIC PROFITS AFTER TAXES (Billions of $, annual rate)	171.1	168.1	169.0	171.0	176.0	183.0	186.0	189.0
% Change over year ago	2.5	-3.1	4.6	5.3	2.9	8.9	10.1	10.5
MONEY SUPPLY M2 (Billions of $, a.r.)	3354.3	3394.5	3396.6	3436.4	3486.8	3533.8	3579.7	3625.4
% Change, annual rate	3.5	4.9	0.2	4.8	6.0	5.5	5.3	5.2

NOTE: All quarterly series are seasonally adjusted; % change, annual rate calculated from prior quarter; calculations based on unrounded data; a.r.=annual rate. *Excluding Commodity Credit Corp. purchases.

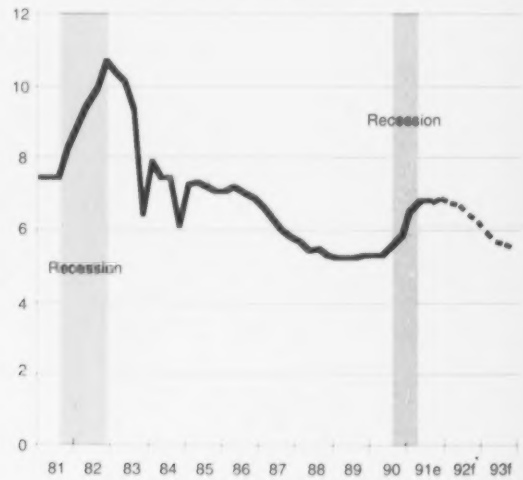
Job Gains Resume

(Change in nonfarm payrolls, 4th quarter to 4th quarter, millions)



Jobless Rate Diminishes

(Percent, quarterly average, civilian labor force)



1993				4th Quarter					
					% Change		% Change		% Change
I	II	III	IV	1991	'91/'90	1992	'92/'91	1993	'93/'92
Forecast				Estimate		Forecast			
6234.5	6327.5	6412.7	6494.5	5754.5	4.1	6141.5	6.7	6494.5	5.7
6.2	6.1	5.5	5.2						
4350.5	4382.8	4411.9	4439.0	4176.2	0.5	4317.8	3.4	4439.0	2.8
3.1	3.0	2.7	2.5						
4334.3	4362.8	4388.7	4412.3	4181.7	-0.2	4305.3	3.0	4412.3	2.5
2.7	2.7	2.4	2.2						
22.0	24.0	25.0	26.0	4.0	N/A	20.0	N/A	26.0	N/A
143.3	144.4	145.4	146.3	137.8	3.5	142.2	3.2	146.3	2.9
3.1	3.0	2.8	2.7						
144.0	145.1	146.3	147.4	137.9	3.1	142.8	3.5	147.4	3.3
3.4	3.3	3.2	3.2						
10.1	10.0	9.7	9.6	8.7**	-8.2	9.6**	10.4	9.8**	2.1
1.37	1.38	1.37	1.39	1.04**	-12.5	1.28**	22.7	1.38**	7.5
114.4	115.4	116.3	117.2	108.7	0.2	113.3	4.2	117.2	3.5
3.9	3.7	3.3	3.1						
111.5	112.0	112.5	112.9	109.0	-0.8	111.0	1.9	112.9	1.7
6.0	5.8	5.7	5.6	6.9	N/A	6.3	N/A	5.6	N/A
193.0	196.0	198.0	200.0	169.8**	2.2	183.5**	8.1	196.8**	7.2
9.7	7.1	6.5	5.8						
3670.7	3715.8	3756.9	3795.7	3436.4	3.3	3625.4	5.5	3795.7	4.7
5.1	5.0	4.5	4.2						

**Annual total. N/A=Not applicable

costs and improving efficiency. Increases in sales and/or output volumes should, therefore, feed through quickly to the bottom line.

Inflation--Winning the Battle

Inflation jumped in 1990, as higher oil prices drove consumer prices up 6.2% from the prior year's fourth-quarter level. The reversal of last year's run-up in oil prices will help cut inflation in half in 1991 to only about 3.1%.

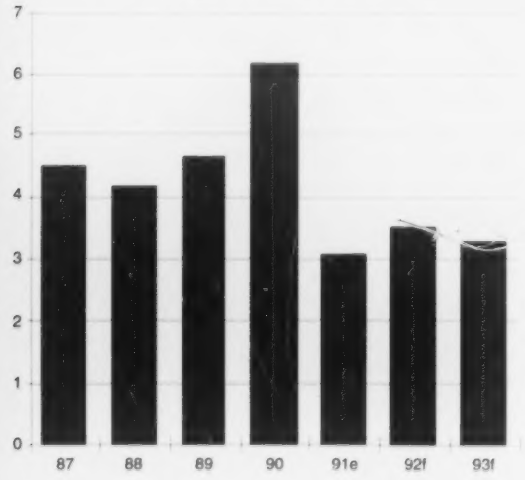
Prospects for inflation appear favorable for the early 1990s. Monetary growth, the dominant force behind inflation, has been slow during the past four years. We estimate that the annual increase in M2 over the five years ending in 1991 will amount to only about 4.3%. Assuming that the economy's potential real growth rate is 2.5%, this would imply that inflation could trend as low as 2%.

Oil and food supply shocks can cause large swings in relative prices, which can affect the general inflation indices. World oil output, however, is likely to match increases in demand. Agricultural supplies are sizable, although prospects will be affected by developments in the Soviet Union, weather, and U.S. farm policies.

On balance, our forecast is for consumer prices to rise 3.5% in 1992 and 3.3% in 1993. Although prices, along with employment, were affected

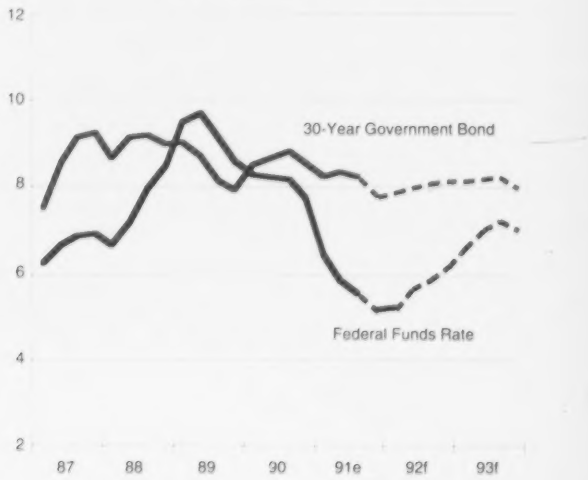
Inflation Remains Low

(Percent change in CPI, 4th quarter to 4th quarter)



Interest Rates--Moderate Cyclical Rise

(Percent, quarterly average)



most significantly in the goods-producing sector during this past recession, more price restraint has recently been evident in service industries. That trend is likely to continue during the next two years.

Wage and salary increases have been temperate for some time. Continued increases in the cost of health care and non-wage benefits are likely to boost the average cost of total compensation by 4.7% during each of the next two years, following 1991's estimated 4.5% rise.

Interest Rates--Milder Cycle

Changes in interest rates during the next two years are likely to be confined to a narrower range than during much of the 1980s. This will reflect a generally moderate pace of economic growth and lower inflation.

The Federal Reserve influences the course of short-term yields through its control of the overnight federal funds rate. Five major forces will guide the Fed in setting its interest-rate targets during coming months: (1) the current and expected trend of economic growth; (2) the pace of monetary expansion; (3) the rate of inflation; (4) the financial market's confidence in Fed policy, as indicated by bond prices; and (5) the dollar's behavior in foreign-exchange markets.

Weak economic and monetary growth, low inflation, and rising bond prices would encourage the Fed to lower interest rates and *vice versa*. The dollar's foreign-exchange rate acts more as an ancillary constraint: a sharp plunge in the dollar could prevent easing and a steep climb could delay tightening.

The federal funds rate is forecast to bottom out at about 5% at the end of 1991 as the Federal Reserve acts to accommodate the economic expansion. For comparison, the fed funds rate reached a peak of nearly 10% in early 1989. An acceleration in economic activity by the first part of 1992 is likely to prompt a gradual process of tightening, taking the funds rate to a peak of about 7.25% by the middle of 1993. Such an increase should be sufficient to restrain the growth of the economy, causing the funds rate to ease to 7.0% by the end of 1993.

Most short-term rates will parallel movements in the funds rate, with a rise of 125 basis points over the course of 1992 and 75 basis points between the beginning and end of 1993. We expect the bank prime rate to average slightly over 8% in 1992 and 9% in 1993, compared with an average of 8.5% in 1991, and well below 1990's 10% average.

Long-term interest rates, as represented by the yield on Treasury securities, will reflect three fundamental factors: (1) the real return, based on the productivity of capital; (2) the anticipated rate of inflation over the life of the asset; and (3) a risk factor based on uncertainty about the prospects for inflation.

The real rate of return currently is around 4%. Its one-half percentage point increase during the past two years may reflect the impact of higher investment demands from Eastern Europe, Asia, and Latin America.

If investors can be convinced that the long-term inflation rate will hold at 3.5% or less, the likelihood is that the 30-year Treasury bond yield will remain near 8%. Our forecast is for the long bond to generally yield less than 8% in the latter part of 1991 and in the early part of next year. Signs of more rapid economic growth and rising short-term rates are expected to push the 30-year bond yield up gradually during the course of 1992, but to a peak of only about 8.25% in the middle of 1993. Following our general outlook for long-term yields, we expect 30-year mortgage rates to range between 9.0% and 9.5% during 1992-93, a welcome respite from the double-digit mortgage rates that characterized nearly all of the 1980s.

FORECAST OF INTEREST RATES

(Quarterly averages)

	1991				1992				1993			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Short-Term	Actual				Forecast							
Fed Funds (Overnight)	6.43	5.86	5.59	5.08	5.25	5.65	5.88	6.25	6.65	7.00	7.25	7.00
Treasury Bills (3-month)[1]	6.02	5.56	5.35	4.93	5.06	5.45	5.68	6.05	6.45	6.80	7.05	6.80
CDs (3-month, secondary)	6.71	6.02	5.70	5.18	5.35	5.75	5.98	6.35	6.75	7.10	7.35	7.10
Eurodollar (3-month)	6.76	6.04	5.69	5.20	5.37	5.77	6.00	6.37	6.77	7.12	7.37	7.12
Prime Rate	9.19	8.67	8.42	8.00	8.00	8.00	8.00	8.47	8.75	9.05	9.50	9.08
Long-Term												
U.S. Government Bonds (30-yr)[2]	8.20	8.32	8.18	7.80	7.90	8.05	8.10	8.15	8.18	8.20	8.25	8.00
Corporate Aaa (Moody's)	8.93	8.91	8.76	8.37	8.40	8.50	8.59	8.70	8.77	8.81	8.87	8.61
Mortgage Rate (Fixed)[3]	9.50	9.53	9.30	8.87	8.92	9.10	9.19	9.30	9.37	9.41	9.47	9.21

(1) Bank discount basis. (2) Yields adjusted to constant maturities. (3) Contract rates on first mortgages, conventional market.

Industry Perspective

The recovery and expansion of various industries in the 1990s will occur under significantly different conditions than in the lengthy expansion following the 1981-82 recession. The boom in consumer spending that lasted through much of the 1980s is not likely to be repeated in this decade, and as a result retail trade and other consumer-oriented industries cannot anticipate any great relief from increased consumer spending. In addition, the surge in leveraged buy-outs has left a number of highly leveraged businesses, with interest expense now consuming over 60% of total pre-tax economic profits in American industry.

Despite the potential difficulties facing U.S. industry during the expansion of the 1990s, several encouraging factors are in place. The increased emphasis on inventory management over the last several years has resulted in an average inventory-to-sales ratio for U.S. business that is roughly 10% lower than it was entering the expansion of the 1980s. Further, because of lower inventory levels and strong exports, and despite the recent declines in corporate profits, the way has been paved for a significant recovery in earnings in the next few years.

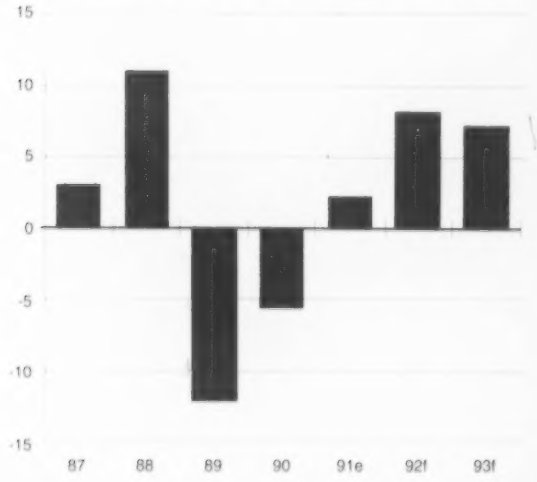
Environmentalism/Government Debt Affecting Industry in the 1990s

The dramatic rise in concerns over the environment in recent years will challenge U.S. industry in the expansion of the 1990s. Stricter air, water, and solid waste regulations at both the state and federal levels will increase costs for many industries. Businesses ranging from large, multinational petroleum and chemical producers to small, local dry-cleaning establishments will be negatively impacted by current and pending environmental legislation. Industries involved in recycling, pollution abatement, and other environmental services, however, should benefit from the increased attention to environmental issues.

Another hurdle for industry in this recovery that was not a problem in the expansion of the 1980s is the lack of favorable tax and other government incentives. The significant debt of federal, state, and municipal governments will force them to forgo long-term strategies that foster industry growth in favor of short-term, revenue-enhancing policies, such as higher corporate and other tax rates.

Profits Rebound

(Percent change in after-tax economic profits from prior year)



Leading the Expansion...

Pharmaceuticals and Medical Equipment

Both of these industries should continue recording double-digit growth in sales and earnings through 1993. Partially because of the nature of demand in these industries, the recession had little or no impact on their operations, and as a result they are well positioned to prosper during the coming economic expansion. Exports and transplant production abroad will remain major contributors to revenue growth for drug makers and manufacturers of medical equipment and supplies.

Health-Care Services

One of the few industries that witnessed an increase in employment during the recent downturn, health-care services (including hospitals, nursing homes, health maintenance organizations (HMOs), preferred provider organizations (PPOs), and offices and clinics of medical professionals) will be among the leaders in the forthcoming expansion. Despite increasing efforts by employers and insurance companies to limit expenditures on health care, most providers of health-care services are unlikely to see a significant curtailment in revenue or earnings growth over the next few years. Although these activities, along with recent government limitations on medicare reimbursements, may limit pricing flexibility, an aging population and innovative new procedures will ensure growing demand and revenues for this industry.

Commercial Aircraft

Commercial aircraft should continue to be the bright spot for the aerospace industry. Expected growth in worldwide airline capacity and replacement of aging fleets will guarantee strong demand for several years to come. The current production backlog in this industry is roughly 3,500 planes, valued at a total $200 billion. Although some airlines may postpone delivery of their current orders because of financial troubles or delays in route approvals, the diversity and international nature of demand for this industry's products will limit the overall impact of such delays on revenues or earnings.

Heavy Construction

Government projects to repair or build bridges, roads, and other transportation and industrial infrastructure in the 1990s will provide substantial opportunities for industrial developers and construction firms. Domestic companies in this industry may face tougher competition from overseas, however, due to heavy spending on innovation and R&D by their foreign rivals over the last several years. Even though Japanese and other foreign companies specializing in heavy construction are somewhat more efficient than their U.S. counterparts, domestic manufacturers of heavy construction equipment and vehicles should see exports grow, as countries in Eastern Europe and Southeast Asia increase their expenditures on infrastructure repair and development.

Other industries leading the expansion will include integrated oil and petroleum producers, housing (in certain regions), telecommunications services and equipment, software, and computer programming services.

Lagging the Expansion...

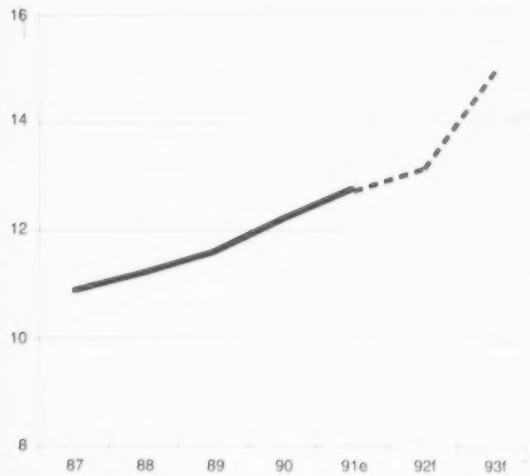
Perhaps more so than at the beginning of the expansion of the 1980s, the current expansion is beginning with a large number of industries in a state of transition. Defense, forestry, retailing, and airlines, as well as motor vehicle and computer manufacturing, are just some of the industries currently undergoing significant change. As these industries move through a period of competitive shakeouts and intensified competition, only the more efficient players will remain.

Automobile Manufacture

After stumbling badly in the first half of 1991, the auto industry will recover

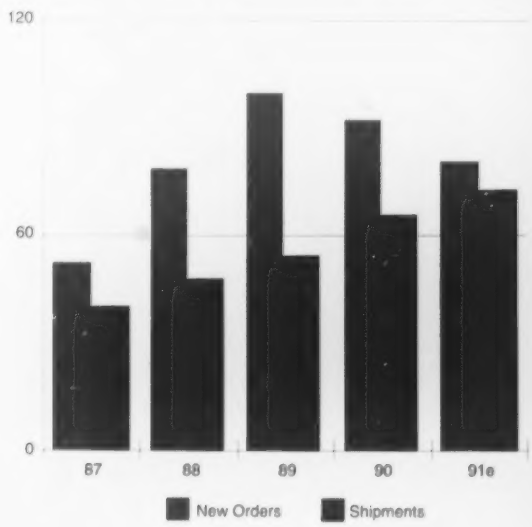
Demand for Health Care Services Will Continue To Grow

(Outlays on health care as a percent of GNP)



Aircraft Shipments Are Catching Up with Orders, but Significant Backlogs Remain

(Billions of dollars, seasonally adjusted)



only slowly during the remainder of the year. As a result, overall sales of cars and light trucks will decline 9% this year from a weak 1990 level. Detroit's "Big Three" (Ford, Chrysler, and General Motors) are likely to report combined operating losses of over $3 billion this year, despite massive cost cutting efforts and severely curtailed production.

The next two years, however, will see a strengthening in domestic sales of motor vehicles, with gains of 10% and 2% in 1992 and 1993, respectively. Japanese and other foreign competitors, meanwhile, have also shown some weakness. Although the overall market share of Japanese car producers will increase in the next two years, foreign gains in such profitable areas as minivans and small trucks will be hampered somewhat by the strong position of U.S. firms and government intervention in these areas.

General Chemicals

This industry has fallen victim to the massive addition of capacity that occurred in the last five years. Profits are likely to decline at least 20% in 1991 on very weak sales volume. The recent recovery in the dollar and slow growth abroad have also hurt exports for general chemical producers, although low and stable oil prices will provide some relief to these companies in the near term. As the expansion gathers steam, chemical manufacturers should see annual sales growth of 4-5% in 1992 and 1993, while profits will grow more substantially. Unlike general chemical producers, specialty chemical makers have more pricing flexibility and lower costs than basic chemical manufacturers and should see double-digit gains in profits through 1993.

Retail Trade

One symptom of the overcapacity in the retail trade industry is evident from the fact that almost one fourth of total department-store sales in the United States are being generated by firms in bankruptcy. Retailing suffered more than most industries in the latest recession as low consumer confidence took a heavy toll on revenues. Total retail sales for 1991 are expected to increase only 2% over weak 1990 levels. As the expansion gains momentum and the competitive shakeout in this industry runs its course, however, sales should grow at a more healthy 5% rate in both 1992 and 1993. Higher consumer confidence should result in greater sales for department, furniture, and apparel stores over the next two years as pent-up demand is transformed into spending by households.

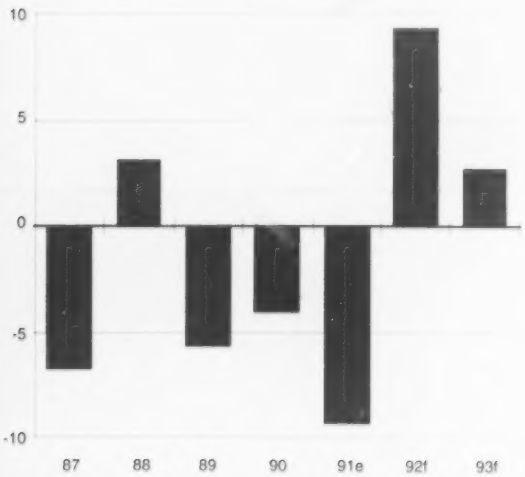
Media

Newspaper and magazine publishers have been suffering from weakened advertising revenues and subscriptions for over a year. Newspapers are expected to post a decline in earnings of some 20% in 1991, while higher postage costs and increased discounting of advertising rates will lead to significant declines in magazine publishers' profits as well. Television stations are faring little better and have also offered discounts to advertisers in an attempt to increase revenues. Currently, the major networks are expected to see profits in 1991 that are as much as 40% lower than in 1990. The outlook for advertising revenues will improve substantially in 1992, however, with both the Olympics and the presidential election contributing to an increase in spending by advertisers.

Other industries that will recover more slowly include airlines, lumber and paper products, primary metals, computers, and trucking.

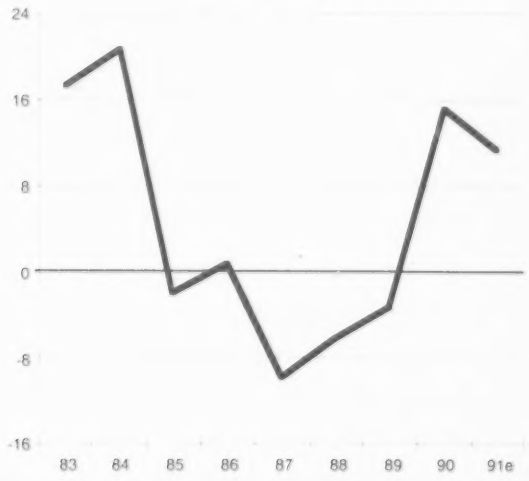
Sales of Cars and Light Trucks Strengthen Again in 1992

(Percent change from prior year)



More Business Failures in Retail Trade

(Percent change from prior year)



Financial Institutions

Since the problems of the savings and loan industry in 1988-89, it seems that the United States has been buffeted by a rolling financial crisis. During 1991, concerns have escalated in financial markets about a possible "crisis" in the insurance industry. Considerable attention has focused on the failure of a few large insurance firms this spring and summer, leading to a decline in confidence about the industry's overall stability. All of this comes on the heels of credit quality problems, restructuring, and poor earnings performance at some of the nation's large banks. With the 1990-91 recession behind us, as we begin a new period of economic expansion, the condition of financial institutions will have a significant impact on the economy. Some help is forthcoming, as Congress is likely to enact bank reform legislation designed to enhance the competitiveness of banks. The deposit insurance system is expected to be revitalized, and nationwide branching will be allowed.

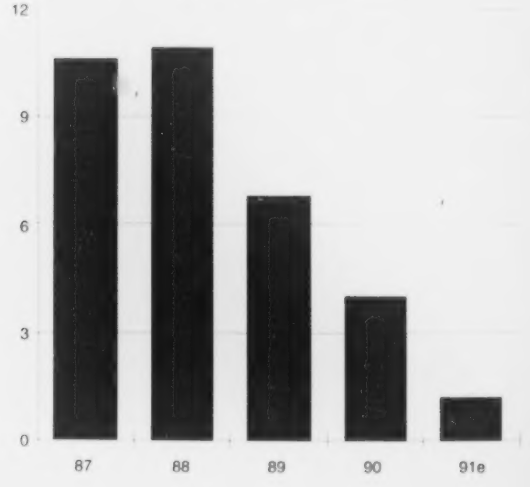
Insurance Failures Disturbing

Given the large number of firms in the insurance industry, the incidence of failure in recent years has been relatively low. In 1990, 67 insurers failed, slightly fewer than in 1989. In the first eight months of 1991, only 17 firms failed, but some very large companies were among them. The failure of large multi-line insurers has raised questions in the minds of policyholders about the ability of other insurers to pay future claims. Many individuals who have bought investment-type contracts worry about the safety of their funds. The record, however, shows that most of these concerns are unwarranted.

The insurance industry has a self-financed "guaranty fund," set up on a state-by-state basis, to pay claims of companies that fail. In the early 1980s, these funds paid out less than $100 million a year to policyholders of failed property/casualty companies. As insolvencies increased in the mid 1980s, these payments rose to a peak of $900 million in 1987 and then declined to $780 million by 1989. The state guaranty funds have always been intended to serve as a last resort after an insolvent insurer has liquidated assets to meet obligations and has transferred policies to healthy firms. In five large states

Profitability of Property/Casualty Insurers Eroding

(Percent, return on equity)



(California, Florida, Illinois, New York, and Texas), reserves in guaranty funds range from $99 million to $287 million, which is insufficient to cope with one large insolvency. As a general rule, policyholders are covered by these funds up to $100,000 in annuities or cash surrender values and up to $300,000 in death benefits.

Two Sub-Industries--Is One More Worrisome?

The performance and stability of the insurance industry must be evaluated for two very distinct segments--life/health (L/H) and property/casualty (P/C). The two accompanying charts show some underlying trends in these two areas of the insurance industry. Property/casualty insurers have seen their profitability eroded severely in the past three years. Operating earnings after taxes declined from an average of $12.0 billion in 1987-88 to $5.6 billion in 1990, and the estimate for 1991 is $1.7 billion. This decline has caused the industry's return on equity (ROE) to plunge to 1.2% in 1991 from an average of 10.8% in 1987-88.

The major factors responsible for this deteriorating performance are: (1) underpricing of products relative to unknown future losses; (2) several catastrophic events--Hurricanes Hugo and Bob, San Francisco's earthquake, and the explosion of a petrochemical plant in Houston; and (3) "cash-flow underwriting" (building large volumes of policies at low prices in order to generate funds to invest). These factors have induced P/C companies to take investment risk in the securities markets. Since the problems affecting the P/C industry are more secular than cyclical, its near-term outlook will not benefit from the economic recovery in 1992-93 as much as L/H underwriters.

Despite their recent difficulties, L/H companies in the aggregate have continued to enjoy faster growth in premium receipts than in benefits paid, a differential of 2.6 to 3.8 percentage points in 1990-91. The recent failure of several large L/H companies stems from their heavy investments in commercial real estate and junk bonds, where there has been a high incidence of default or falling values. A cyclical upturn in residential real estate markets in 1992-93, which we anticipate, will not help this segment of the industry much (L/H companies do not invest heavily in residential property). Continued problems in commercial real estate, by contrast, will be a drag on this industry's performance in 1992-93. However, as junk bonds used to finance corporate takeovers in the mid 1980s mature in the early 1990s, this problem will gradually ease.

One of the more worrisome aspects of L/H companies is their heavy issuance in recent years of guaranteed income contracts (GICs). Because these instruments guarantee the investor a high yield for a long period, L/H companies have felt pressure to invest in high-yielding (but riskier) bonds and real estate. In 1992-93, large volumes of GICs (backed by commercial mortgages) issued in the mid 1980s will come due.

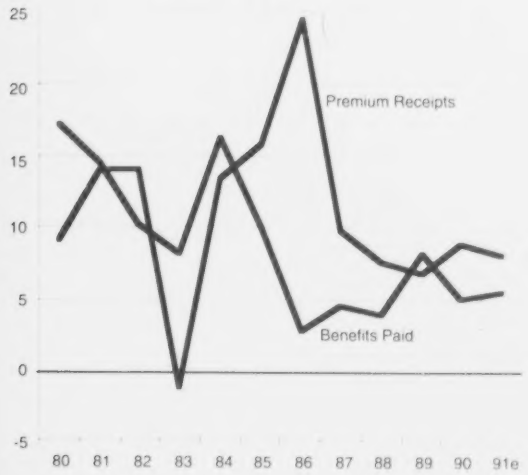
Banking Reform Gains Momentum

Congress is now close to enacting legislation to restructure and modernize the nation's banking system. These changes, when implemented, could make a significant difference in the domestic and international competitiveness of banks. While many of the top U.S. banks reduced their assets as they worked off bad loans, foreign banks continued to expand during the past decade. A recent survey showed that Citicorp, the largest U.S. banking organization and the world's largest bank in 1980, dropped out of the world's top-20 list in 1990. A total of 12 Japanese banks are in the top-20 list, which also contains eight European banking institutions.

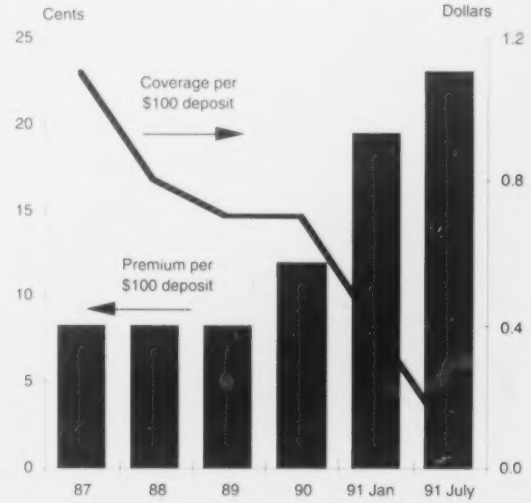
With the Single European Market (EC 92) progressing steadily, and given the recent inroads that foreign banks

Life/Health Insurance Receipts Outpacing Benefits Paid

(Percent change from prior year)



Bank Insurance Coverage Near Zero



have made in the U.S. market, removal of restrictions and obstacles that have hampered U.S. banks is long overdue. It is now quite likely that many of the Treasury bank-reform proposals will be enacted into law by either the end of 1991 or early 1992.

Expanded Bank Powers Likely

Interstate branching is expected to be part of the reform package implemented in 1993. To the disappointment of many in the banking community, however, both the House and the Senate versions of the bill would allow states to opt out before 1993. The potential for diversifying credit risk geographically and over a broad range of industries would be a major factor in strengthening banks. Certain banks are well-positioned to benefit from the increased economies of scale that interstate branching would provide, while reducing the number of banking institutions in the nation would help to lessen the overcapacity problem.

Glass-Steagall restrictions against securities underwriting by banks are likely to be eased only slightly, but the Federal Reserve will be given greater discretion to approve applications for broader powers on a case-by-case basis. Authorization of banks to engage in the sale of insurance products is likely to be expanded, but the extent of insurance underwriting powers is quite uncertain.

Deposit Insurance To Be Revitalized

Although Congress has failed to address the moral hazard issue--the flat-premium system that encourages high-risk taking without fear of loss--some important changes are likely. The FDIC's borrowing privilege from the Treasury is likely to be expanded by as much as $70 billion. Despite the sharp increase in deposit premiums in 1990-91 from 8.3 cents/$100 of deposits to 23 cents as of mid 1991, the Bank Insurance Fund will be virtually empty by the end of 1991. Premiums are likely to be raised as early as mid 1992 in order to boost the reserves of the insurance fund.

The "too-big-to-fail" doctrine is still in contention among congressional committees, but it is not likely to be changed in the next two years. All attempts to reduce the coverage of depositor accounts ended in failure.

Nonperforming Loans Leveling Off

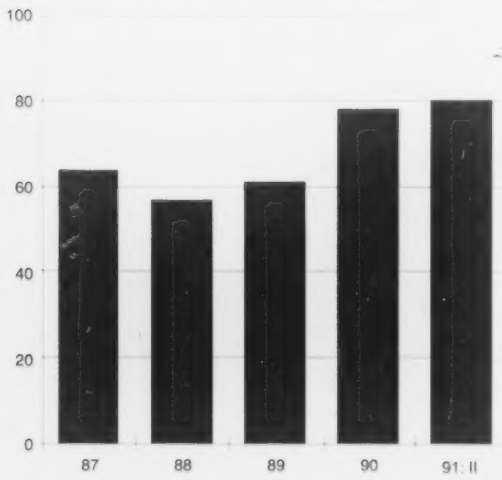
Perhaps the single biggest problem plaguing large U.S. banks is the overhang of nonperforming loans (NPLs), which require large loss provisions that erode earnings and capital. As the accompanying graph shows, all insured commercial banks had $80.1 billion in NPLs at mid 1991. This was virtually level with the volume of NPLs at the end of 1990. NPLs as a percent of total loans for the banking industry have now crossed the 4% mark, up from 3.25% in 1988.

Since the largest share of NPLs involves real estate loans, how quickly banks are able to reduce this level will depend on the strength of the economic recovery during 1992-93 and the turnaround in real estate markets. The regional profile of the recovery will also affect how quickly certain banks are able to see improvement in their NPL problems.

The ability of banks to cope with loans that must be charged off in the future will vary with the asset size of individual banks. At the end of March 1991, the forty-six largest banks (assets greater than $10 billion) had the lowest "loss allowance/NPL" ratio of the four size groups, 59% (see accompanying graph). For mid-sized banks, assets of $1-10 billion, the ratio was a much higher 69%. Reserving for future loan losses has increased at banks of all sizes and reflects the swing towards a more conservative attitude of banks with respect to financial planning.

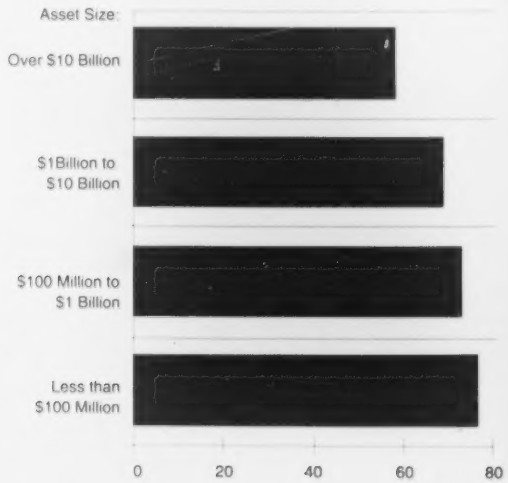
Nonperforming Loans at U.S. Banks Leveling Off

(Billions of dollars, end of period)



Loss Allowance Lowest at Large Banks

(Percent, loan loss provision to nonperforming loans, 1st quarter 1991)



The horizons of the international economy have expanded dramatically in the recent past. Among the major developments that will affect global markets during the forecast period, the introduction of market economies into countries that formerly practiced central planning has received much attention. The integration into the Western economic system of this group of economies--larger in population than the European Community--expands the scope of that system considerably.

Nevertheless, the collapse of communism is only one of the structural changes occurring in the international economy. Other changes that can be cited are the completion and likely geographic expansion of the Single European Market. A single currency, challenging the role of the dollar, may be part of this process. The creation of a North American Free Trade Area and its possible extension to include some South American countries is a further development on the horizon. In general, it can be said that barriers to trade and investment are being reduced in much of the world.

Stronger Growth for Industrial Countries during 1992-93

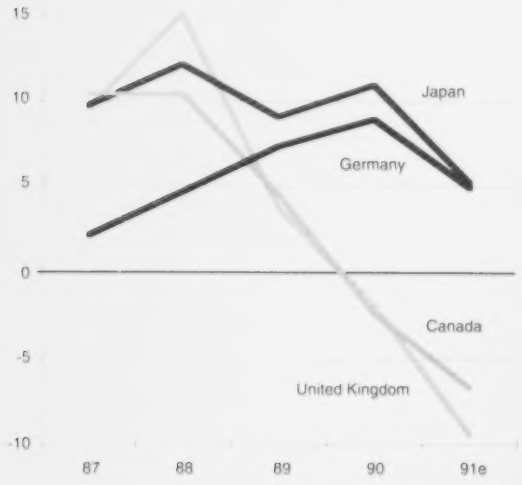
Economic growth and investment in the major industrial countries slowed considerably during the second half of 1990 and the first half of 1991, the result of tighter monetary policies and uncertainty surrounding the Gulf war. Aside from the United States, recessions occurred in Canada and the United Kingdom. In continental Europe, both France and Italy experienced much lower growth than during the previous several years. Japan and (western) Germany were the major exceptions to the slowing of growth during 1990, but growth in both these countries has decelerated during 1991.

The outlook during the forecast period is for a pickup in activity, with inflation falling to relatively low levels. Lower core inflation is already evident in a number of countries, although German inflation has risen during 1991 in response to pressures surrounding the unification of the two parts of the country.

Germany is likely to be the most rapidly growing of the major industrial countries in the coming two years, following some slowdown this year. The growth of the unified economy has fallen as a result of declining output in the eastern part of the country, but a turnaround in this region can be

Investment Slows

(Annual percent change in gross fixed investment)



	Real Economic Growth (GDP, annual average % change)				Inflation (CPI, annual average % change)				Current-Account Balance (Billions of dollars)			
	1990	1991e	1992f	1993f	1990	1991e	1992f	1993f	1990	1991e	1992f	1993f
Japan*	5.7	4.5	3.0	3.3	3.1	3.5	2.4	2.2	35.9	75.0	60.0	40.0
Germany*	4.5	1.8	3.5	3.8	2.7	3.5	3.6	3.0	44.0	-6.5	5.4	11.7
France	2.8	1.6	2.8	3.0	3.4	3.3	3.2	2.8	-9.9	-7.4	-9.2	-6.4
Italy	2.6	1.6	2.6	3.4	6.5	6.2	5.0	4.2	-12.7	-13.8	-11.6	-14.3
United Kingdom	0.7	-1.8	2.3	2.8	9.5	6.4	4.0	3.0	-23.5	-14.7	-8.5	-5.0
Canada	0.9	-0.8	2.4	3.0	4.8	5.5	3.5	3.1	-18.8	-14.6	-10.8	-7.2
Total of above countries	3.8	2.2	2.9	3.3	4.3	4.2	3.3	2.8	15.0	18.0	25.3	18.8
G-7 (Above + U.S.*)	2.7	1.2	2.9	3.2	4.8	4.3	3.3	3.1	-77.1	4.4	-29.9	-40.1

*GNP used for real growth

expected in the 1992-93 period.

During 1991, eastern Germany's total output will contract by 15-20%, with very high unemployment resulting from the uncompetitiveness of many of the region's enterprises. The costs associated with this precipitous drop in output and jobs have contributed to a significant increase in the German government budget deficit. As privatization and investment take hold, however, a return to positive growth in the eastern part of Germany should occur, raising the all-German growth rate.

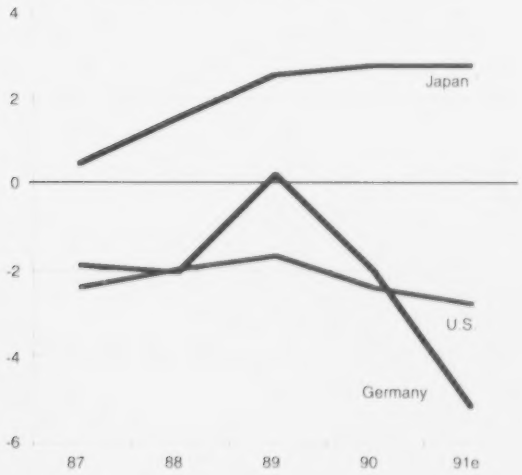
Monetary policy in Germany was progressively tightened during 1990 and 1991 to prevent inflation from continuing to escalate. Because Germany is the largest economy in the European Community, this tightening of policy has had an important influence on economic developments elsewhere in Europe. Interest rates have been quite high in real terms in most European countries due to the exchange-rate mechanism of the European Monetary System. These high rates of interest have dampened economic growth, but also kept inflation at low levels.

During 1991, and most of the forecast period, German inflation will probably exceed that in France and a number of smaller economies for the first time in recent years. As this situation persists, monetary policy in the European countries outside Germany is likely to be eased somewhat, contributing to higher rates of economic growth. Thus, during 1992 and 1993, European growth is expected to increase from its low level in 1991. In the United Kingdom, which has experienced a sharp recession, a return to positive, although restrained, growth is already occurring.

During the 1992-93 period, economic growth in Japan is expected to slow substantially, although it will still be in the neighborhood of 3% annually. During the four years through 1991, Japanese growth had been the most rapid of the seven largest industrial countries. During 1990 and 1991, however, monetary policy was tightened and the economy has begun to slow as a result. In addition, the Japanese financial system is undergoing change due to increased capital requirements, a drop in stock prices, and some problems in real estate markets. These changes have com-

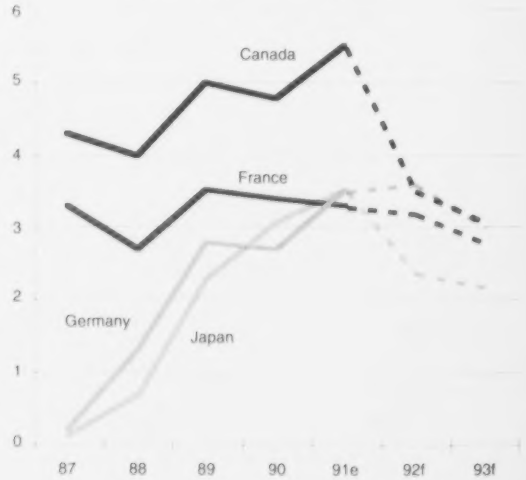
Cost of Unification Raises German Budget Deficit

(General government balance as percent of GDP/GNP)



Inflation To Stay Low

(Percent change in consumer prices)



pounded the effects of the restrictive monetary policy, reducing liquidity considerably.

The pattern of international capital flows has been affected by a number of special events in the recent past, including the unification of Germany, the Gulf war, and financial market developments in Japan. During 1991, the German current-account surplus--earlier the major source of financing for other European countries--has been eliminated as resources have shifted toward the former East Germany. Over the forecast period, it is likely that the German current-account balance will return to surplus, but the surplus will be much smaller.

Reform Taking Hold in Eastern Europe, USSR

Although the pace of economic reform varies from country to country, progress in establishing the basic prerequisites of market economies has been made in some countries of Eastern Europe. These prerequisites include, among other things, laws allowing and protecting private property, the freeing of prices, the privatization of state-owned enterprises, currency convertibility, and the reduction of barriers to foreign trade and investment.

While all the Eastern European countries and the USSR have experienced relatively severe economic contractions and high inflation during 1991, the outlook during the 1992-93 period is for positive growth to return in most of them. Czechoslovakia, Hungary, and Poland are likely to lead the way, since these three countries have made the most progress in establishing the necessary institutional frameworks. Opportunities for Western participation in the economic growth of these countries are likely to increase in the coming years.

In the republics of the former USSR, the problems seem much greater than in Eastern Europe. Nevertheless, the necessity of moving more quickly toward reform has been clearly demonstrated by the rapid economic deterioration that has occurred during the past year. Real output in these republics may decline by an average of 10-15% during 1991, while inflation has reached unprecedented, triple-digit levels.

The events of the late summer in the Soviet Union strengthened the position of those favoring economic reform. As a result, it is likely that movement toward market economic systems will accelerate during the forecast period. At the same time, the short-term negative effects of economic restructuring may be exacerbated by the devolution of power toward the individual republics and the complete independence of some of them. These trends will probably result in the introduction of new currencies, uncertainty over legal regimes, and a reluctance on the part of private investors to participate until the rules become clearer. Although the potential gains from economic reform are very great over the long run, the outlook for the immediate future remains clouded. The financial position of the USSR was in serious jeopardy prior to the apparent breakup of the union; it is not yet clear how the external financial obligations of the USSR will be handled.

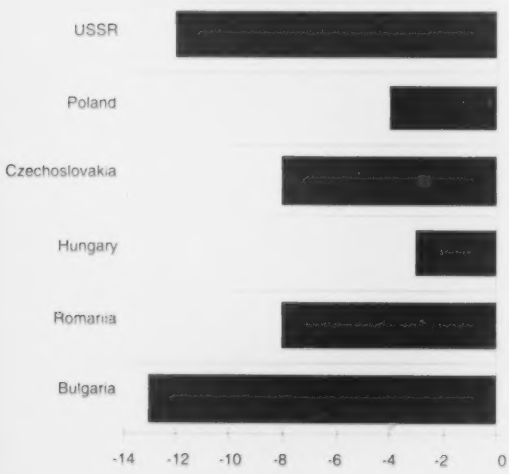
World Trade Rebounds in 1992

In 1991, industrial-country real economic growth has slowed for the third consecutive year, and world trade reflects that sluggishness. We expect that the volume of world imports, *i.e.*, imports adjusted for price changes, will increase about 2% in 1991. In 1992 and 1993, however, the volume of world trade should recover strongly as the industrial countries expand more rapidly.

In 1991, the weakness in non-energy commodity prices and declining inflation rates in most countries have been only partially offset by higher

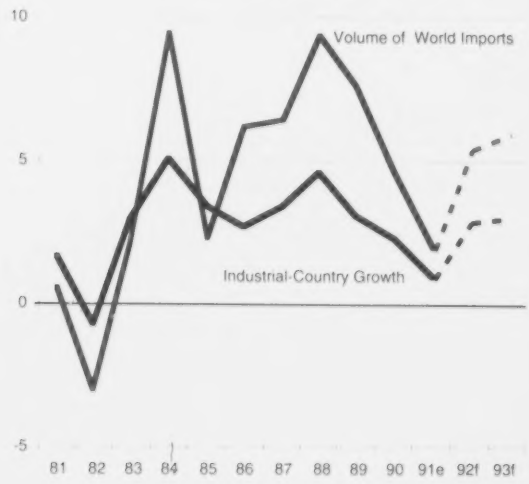
E. Europe Reforms Have Short-Term Costs

(Estimated percent change in real GNP, 1991)



Volume of World Imports Reflects Real Economic Growth in Industrial Countries

(Percent change from prior year)



WORLD TRADE

(Imports, percent change)

	Volume	Prices	Nominal
1985	**2.3**	**-1.7**	**0.6**
1986	6.2	3.9	10.3
1987	**6.4**	**10.0**	**17.0**
1988	9.3	4.7	14.5
1989	**7.6**	**0.9**	**8.6**
1990	4.6	9.8	14.8
1991e	**2.0**	**5.8**	**7.9**
1992f	**5.5**	**5.0**	**10.7**
1993f	**6.0**	**5.5**	**11.8**

energy prices. Consequently, import prices are estimated to incease less than the nearly 10% rise in 1990. In 1992-93, we expect inflation rates to trend downward in industrial countries, but non-energy commodity prices should rebound fairly vigorously.

The economic expansion that has commenced in 1991 is likely to be different from that during 1983-90. In the last expansion, the volume of world trade rose at nearly a 6% annual rate, while prices increased only 2.4% per year. Price increases were held down by a prolonged period of deflation--the import price index actually declined during the five years, 1981-85.

In the expansion of the 1990s, the volume of world trade should increase more rapidly than during 1983-90 if collective industrial-country real economic growth is similar to that for the earlier period. (During 1983-90, industrial-countries recorded real economic growth of approximately 3.5% annually.) In the prior expansion, growth in the volume of world trade reflected the shift of several economies to a greater market orientation. In Asia, a second tier of rapidly growing economies began to form, led by Thailand and Malaysia. In addition, China posted strong economic growth.

During the 1990s, other countries are likely to add to world trade growth. In the 1980s, most of Latin America was a drag on trade as these economies went through a period of profound stagnation. Several of these countries will blossom during the 1990s. In addition, Eastern Europe and the republics of the former Soviet Union will now carry out their trade in hard currencies. Consequently, the volume of world trade is likely to increase more rapidly than in the prior expansion.

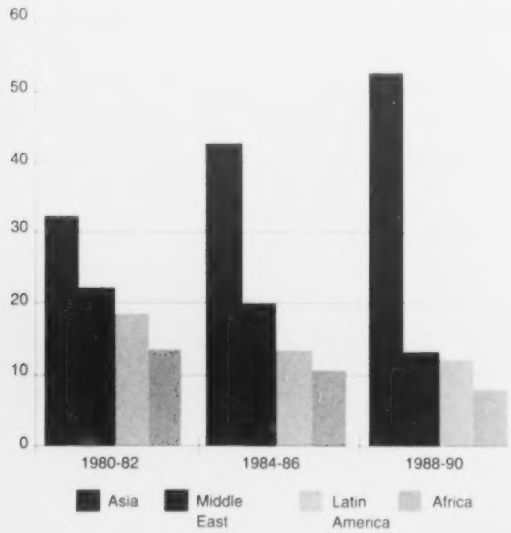
Developing Countries To Revive

In 1990, aggregate economic growth in the developing countries fell to its lowest level since the 1982 recession, although economic performance varied considerably by region. While Asian developing countries continued to grow fairly rapidly, their growth was also slower than during the previous seven years. Because of severe problems in some countries, aggregate growth in Latin America and the Middle East was negative. In 1991, a return to positive growth appears to have occurred, and by 1992 it is expected that developing countries will return to fairly vigorous rates of expansion.

Aside from the countries of East and Southeast Asia, certain Latin American countries will show considerable increases in economic growth during the forecast period. Economic reforms, including trade liberalization, privatization, and improved fiscal policies have allowed these countries to overcome the obstacles to development that caused living standards to decline during the 1980s. Already, Chile and Mexico have returned to international credit markets, while Venezuela and Colombia have accelerated the pace of economic reform. Argentina is also embarking on a new economic reform program. Free-trade areas have been created among several groups of countries in Latin America, and more agreements that include the United States may be reached.

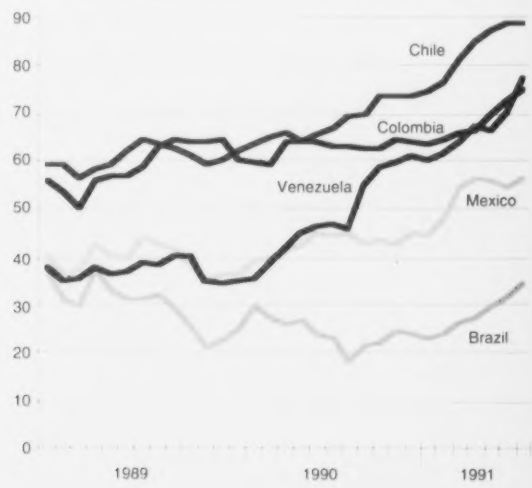
Developing Asia's Imports Rise

(Percent of developing country imports)



Latin Creditworthiness Improves

(Price of debt on secondary market, percent of face value)



U.S. Current-Account Deficit at a Lower Level

The U.S. recession and the crisis in the Gulf have caused the current-account deficit to tumble in 1991. The recession will result in an estimated 1.8% contraction of merchandise imports during 1991, even with growth during the second half of the year. Although we expect the economy to expand during the third quarter, import growth is likely to continue weak until definite signs of revival in consumer spending appear. Simultaneously, export growth remained strong during first half 1991, as most other industrial economies and important parts of the developing world continued to expand.

The Gulf crisis helped produce a $28 billion public-sector transfer inflow in the first half of 1991 as other countries paid for the U.S. contribution during the crisis. More contributions will be made in succeeding quarters.

We expect a larger services surplus in 1991, partly the effect of decreased outlays for U.S. travel abroad that reflect both the Gulf crisis and the recession. The income surplus resulting from investment flows should also rise. Inflows have remained strong as interest rates abroad either rose or stayed relatively high and as economies abroad continued to produce healthy profits, benefiting U.S. participants. In the United States, however, the sluggish economy has generated anemic earnings and caused many businesses to cut dividends, decreasing the outflow to foreign owners of businesses. In addition, U.S. interest rates have fallen, resulting in lower yields on foreign holdings of U.S. Treasury and other assets.

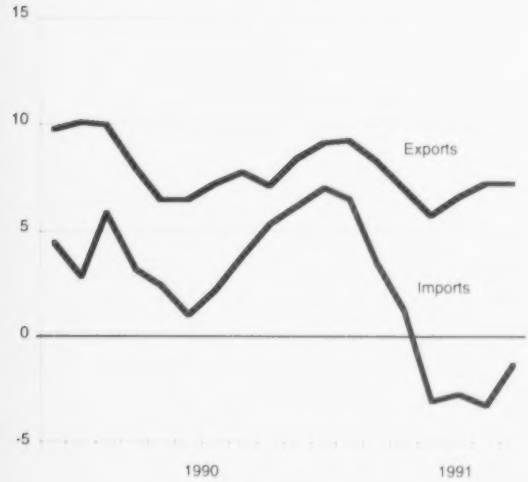
In 1992-93, export growth is expected to remain strong. The foreign-exchange value of the dollar should support export growth and the world economy should grow more vigorously. Developing countries and perhaps Eastern Europe should be improving markets for U.S. capital goods and industrial supplies. Despite the rise in exports, U.S. economic growth in both years should boost import growth and result in an increased trade deficit. Nevertheless, the 1993 trade deficit will be only about half the $160 billion shortfall of 1987.

We anticipate that the services surplus will rise in the forecast period from 1991's level, but that the incomes surplus will decrease. The increase in the services surplus reflects several developments. U.S. firms should do well providing services with the stronger expansion of the world economy. Earnings from insurance and royalties should grow, with even

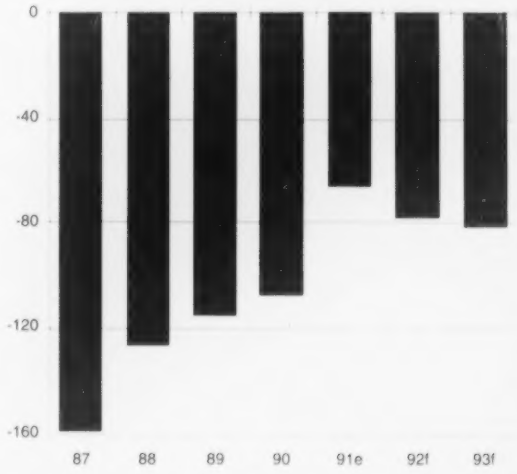
U.S. CURRENT ACCOUNT
(Billions of U.S. dollars)

	1988	1989	1990	1991e	1992f	1993f
Trade balance	-127.0	-115.9	-108.1	-66.6	-78.8	-81.9
Exports	320.3	361.5	389.6	422.0	453.8	488.0
Imports	-447.3	-477.4	-497.7	-488.6	-532.6	-569.8
Service balance	10.3	22.4	26.4	30.8	36.1	37.3
Service exports	102.4	116.5	133.3	141.0	154.3	168.3
Service imports	-92.1	-94.1	-106.9	-110.2	-118.2	-131.1
Income balance	5.4	2.7	11.9	16.1	13.0	13.7
Income: credit	110.7	128.7	130.1	129.8	146.1	156.1
Income: debit	-105.3	-126.0	-118.1	-113.7	-133.1	-142.5
Transfers balance	-14.9	-15.5	-22.3	6.0	-25.5	-28.0
Official	-10.5	-11.1	-17.5	11.2	-20.0	-22.0
Private	-4.4	-4.4	-4.8	-5.2	-5.5	-6.0
Current-account balance	-126.2	-106.3	-92.1	-13.6	-55.2	-58.9

Gap between Export and Import Growth Widens
(Percent change in 3-month moving average from prior year)



U.S. Trade Deficit Smaller in Early 1990s
(Billions of dollars)



stronger growth if the Uruguay Round on trade negotiations is successful. One of its primary goals is increased intellectual property rights protection, which would benefit patent and trademark holders. Furthermore, the value of the dollar and the stronger world economy will promote tourism from abroad. At the same time, however, we look for U.S. travel abroad to rebound with the healthier economy.

The lower investment income surplus results from improved earnings of firms in the United States, the rise in domestic interest rates, and falling foreign rates. Enhanced profits and rising U.S. interests rates will increase income outflows, while lower interest rates abroad will moderate the growth of income inflow.

Dollar Eases Until Mid 1992, Then Strengthens

For some time, the U.S. dollar will be under pressure. After the unsuccessful Soviet coup attempt in August, the dollar surrendered its "safe-haven" appeal, and economic fundamentals should rule, barring another crisis.

With a sluggish U.S. recovery under way, we expect interest rates to decline through the remainder of 1991. Even though we look for inflation to ease, real U.S. short-term rates will fall. By the fourth quarter of 1992, they will begin to rise noticeably, as the Federal Reserve begins to tighten monetary policy.

Overseas, both the Bundesbank and the Bank of Japan are pursuing restrictive monetary policies to try to subdue inflation pressures. In Japan, the growth of M2 + CDs, the favored monetary aggregate, was reduced to 3.4% in July on a year-over-year basis from 13.2% in May 1990. This anti-inflation policy has been undertaken when consumer prices are rising at a relatively moderate 3-4%. Meanwhile, the Bundesbank tightened monetary policy to fight inflation pressures resulting from the economic unification of the former east and west German economies. Both the Bundesbank and the Bank of Japan are likely to ease, the Bank of Japan first as it appears to be more successful in bringing down money-supply growth to within its target range.

Thus, real interest-rate differentials between the United States and major markets abroad should lead to the dollar losing ground against both the yen and the mark through early 1992. Subsequently, U.S. monetary policy will tighten, while policies abroad are likely to be somewhat easier.

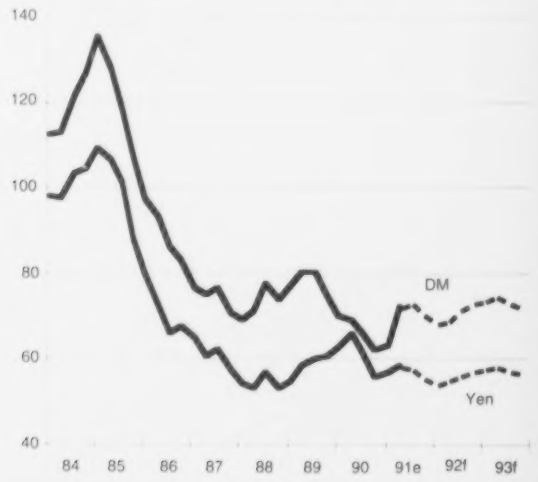
Another factor playing a role will be the resurgence of Japan's external accounts. After recording a $36 billion current-account surplus in 1990, Japan will record at least a $75 billion surplus in 1991. Japanese exports have swelled, while imports have contracted. In 1992, Japanese export growth will continue strong as the U.S. and Canadian recoveries gain momentum. If the exchange rate were determined only by real interest-rate differentials and external balances, the yen could reach the ¥100-120 range against the dollar. The market is aware, however, of the potential for tight monetary policy causing considerable downside pressure on the stock market and on real estate prices in major metropolitan areas.

Germany's current-account balance has deteriorated substantially in 1991, but it should improve during 1992-93. This will give some support to the mark.

In the first quarter of 1992, we look for the dollar to be trading 7-8% below its recent second-quarter 1991 peak against the yen and 5-6% lower against the mark from its third-quarter peak. By mid 1993, we expect the dollar to have strengthened about 9% against the mark and 7.5-8.0% against the yen.

U.S. Dollar to Weaken Through Early '92

(Index, 1983=100, quarterly average)



First Interstate Territory

First Interstate has affiliate and franchise relationships with banks in 18 states, spanning the western, southern, and north central parts of the country.

The Territory did not escape the impact of the recent national recession, but effects were generally milder than in many areas. California appears to be the only FI state which will experience a decline in average nonfarm employment in 1991, although other western states have registered notable slowing. Such deceleration has been particularly evident in Nevada, Oregon, Washington, and Hawaii. The recession's impact dampened income growth in FI Territory to an estimated 4.4% in 1991. We expect personal income to advance by 6.2% in 1992 and 6.6% in 1993.

A number of factors will help performance of various FI states during 1992 and 1993. The general economic recovery will bolster demand for electronics and other capital goods, give some boost to metal mining, and strengthen tourism. An upturn in homebuilding will help the lumber and wood products industry, exports will see further gains, and oil prices will support a moderate amount of drilling. Agricultural conditions will vary widely among commodities, but the farm sector's financial situation has improved. Finally, population growth in many Territory states will be sizable, supporting demand for housing, retailing, and services.

Certain forces will restrain growth. Defense spending is likely to trend downward at a real average rate of about 5% per year, natural gas prices are depressed, and the overhang of commercial real estate persists.

Regional Differences in the Territory

The Territory fell behind the nation in terms of economic growth during the mid 1980s, as the collapse in energy prices affected states in the Rocky Mountains and the South. Since 1989, job and income growth in the Territory has outpaced the national trend, a pattern expected to persist through the forecast period.

Pacific Northwest (Alaska, Idaho, Oregon, and Washington)

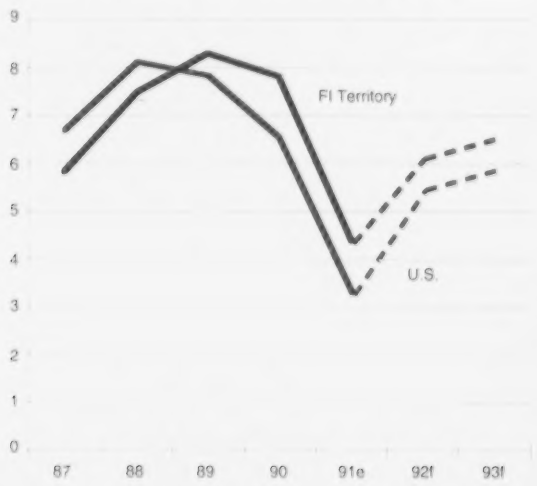
The Pacific Northwest is likely to show the strongest growth in the Territory during 1992 and 1993. Better prospects for housing construction will help the region's important lumber and wood products industry, although imports from Canada could increase, and legal challenges to logging on federal lands will hold timber supplies in question.

Growth in Washington's economy should pick up again during the next two years, although the increase will be more restrained than during the 1988-90 period. The state's key employer, Boeing, plans to hold employment stable in the near term, but the company's current $95 billion backlog will support five years of work.

Oregon's growth will also resume a faster track, helped by manufacturing gains in wood products and electronics. Population increases, especially

FI Territory Maintains Growth Edge

(Percent change in personal income from prior year)



immigration from California, will spur retailing, construction, and various service industries.

Idaho recently has been one of the nation's strongest performing states, and that trend is likely to continue in 1992-93. The state's high-tech industry will generate further jobs in engineering and business services. Because the state received little benefit from defense contracts in the 1980s, it will experience minimal impact from spending cutbacks in the 1990s.

Alaska is currently the nation's largest producer of crude oil, but the high cost of exploration in the state and environmental concerns are likely to restrain potential output. Alaska is forecast to post small increases in total employment during each of the next two years. In contrast to the national trend, home construction picked up substantially last year and is up strongly again in 1991.

Pacific Southwest (Arizona, California, Hawaii, and Nevada)

Growth in the Pacific Southwest has recently slipped below the Territory average, but prospects should improve over the forecast period. California's economy has experienced much of the force of the national recession, a trend also seen in the 1982 contraction. Defense cuts have aggravated the downturn in manufacturing. The state's economy should gradually turn up with the nation, however. With housing construction currently running below the rate of household formation, homebuilding should pick up in 1992-93. (For additional information, see the *California Edition* of the *Forecast.*)

Arizona's economy has also been hurt by defense cuts, as well as by the excess supply of commercial real estate. Office vacancy rates in Phoenix and Tucson are gradually drifting lower as new construction has virtually stopped. The state will continue to show substantial gains in overall employment, which will allow the excess space to be slowly absorbed.

Nevada's economy was jolted in the first part of 1991 as the Gulf war and recession dented tourism. We estimate that employment growth decelerated from the strong increase of 7.4% in 1990 to about 2.5% in 1991. Growth should step up to about 3.5% in 1992 and 4.0% in 1993. The state's outlook will depend on the hotel/gaming industry's success in attracting the "baby-boom" generation to Nevada as a "destination resort."

Hawaii's economy was also dampened by the slowdown in tourism earlier this year, especially from Japan. Prospects for tourism and Hawaii's overall economy should improve in 1992-93. Continued advances in Japanese income will support more travel to the state, and Japanese tourists generally spend about twice as much per day as do visitors from the U.S. mainland. Housing construction has shown an increase this year in Hawaii, but Japanese investors have turned much more cautious regarding nonresidential properties. An excess of luxury hotel space is presently a key concern.

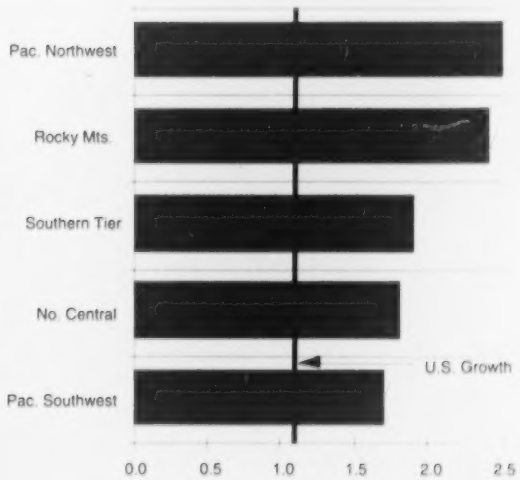
Southern Tier (Louisiana and Texas)

The Southern Tier states are emerging from the "boom-bust" cycle of the 1980s. Texas continues to diversify away from its heavy dependence on oil and gas extraction and will outperform the nation in employment growth during the next two years. The state has built a strong petrochemical industry along the Gulf Coast and is benefiting from trade with Mexico. Health care is also a rapidly expanding industry in the state. Although three military bases are being closed, the state will see a net gain in jobs because of reassignments from other states.

The major constraints facing Texas are declining orders for military hardware and the remaining surplus of office and other commercial space. Office vacancy rates are edging down

Pacific Northwest and Rocky Mountains To Lead in 1992

(Percent change in nonfarm employment)



but remain above the national average.

Louisiana is also recovering from the energy-led slump and is being helped by increased investment in the state's chemical industry. Energy prices in the $20-21 a barrel range will support a moderate amount of petroleum exploration, as well as production of oil field and refinery equipment.

Rocky Mountains (Colorado, Montana, New Mexico, Utah, and Wyoming)

The Rocky Mountain area will nearly match the growth performance of the Pacific Northwest in 1992-93. This region continues to recover from the swings in oil and other commodity prices during the 1980s, as it also whittles down the excess capacity built in some areas during the boom years.

Colorado's economy has returned to a trend of steady growth and should show performance similar to the nation's during the next two years. The Denver area will benefit from the new airport's construction, and the state's housing permits are up for the second year in a row. Colorado, however, will have to adjust to military base closings.

New Mexico is dependent on defense spending and will be hurt by reduced outlays for military research and development. The state is forecast, however, to show moderate gains during the next two years, led by increases in trade and services.

Wyoming is linked to the U.S. and world economies through its reliance on commodities and tourism. Mining for coal and soda ash should show an increase, but natural gas drilling will remain weak. Tourism should be an important positive for the state during the next two years.

Montana will show modest growth, with benefits from higher lumber production and tourism. The state has few military contracts and has not been slated for near-term base closings. The agricultural sector should be helped by an improvement in wheat prices and continued relatively high cattle prices. Oil drilling will continue to show limited improvement.

Utah has registered further sizable job growth this year, a pattern likely to continue in the next two years. The size and quality of its work force have made Utah an attractive site for employers. Lower defense spending will impact the state, but the electronics industry is still likely to expand. Meanwhile, further advances can be expected in various business services and in health care.

North Central (Iowa, North Dakota, and South Dakota)

The North Central region will probably outperform the U.S. as a whole during the next two years, continuing a recent pattern. The region will benefit from larger grain exports to the USSR and other countries.

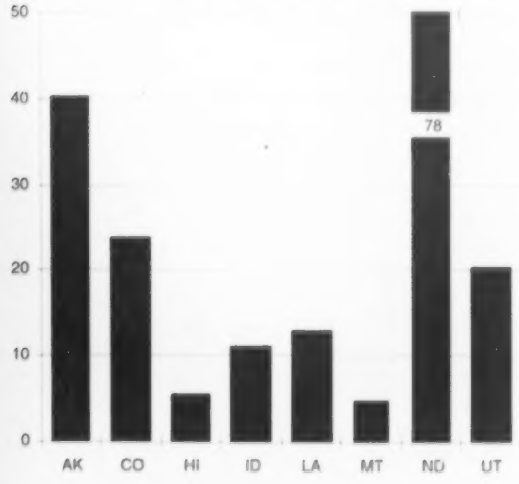
Iowa is forecast to show slow, steady growth during the next two years. Higher corn production would bolster the farm equipment and supply sector. Growth in the general U.S. economy will boost the state's home appliance, rubber, and printing/publishing industries. The state also continues to attract biotechnology firms.

North Dakota is likely to show modest gains in the next two years, although housing activity has soared in 1991. The state should continue to see a moderate amount of oil exploration and extraction. The farm sector will fluctuate with grain and cattle prices, but debt burdens have been reduced substantially. Defense cuts will hurt the state.

South Dakota's growth recently has been impressive. Although gains are likely to moderate during the next two years, they will remain well above the national average. Manufacturing can be expected to show increases in such areas as rubber and plastics and nonelectrical machinery. Further advances can also be expected in health care, finance, and other service industries.

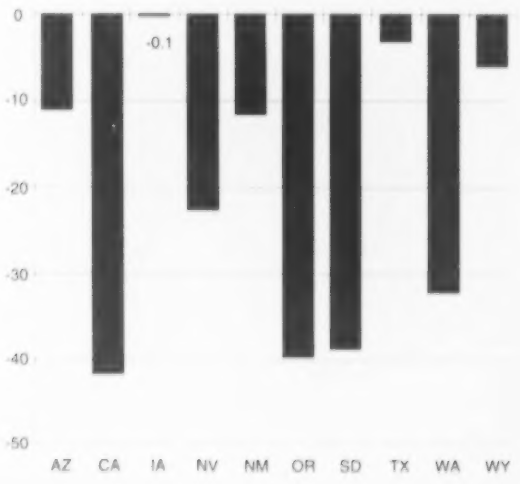
Housing Permits Rise in Some Territory States

(Percent change, first 7 months of 1991 over 1990)



Housing Permits Lower in Other Territory States

(Percent change, first 7 months of 1991 over 1990)



State Finances Worst in 20 Years

One of the casualties of the 1990-91 recession has been state and local government finances. The recession had the double effect of eroding tax revenues and raising the demand for public services, leaving in its wake 26 states with "temporary" budget deficits in fiscal 1991 (ended June 30, 1991). These states raised taxes by an aggregate $10 billion in order to bridge the financial gap and adhere to their constitutional provisions against running deficits. The combined year-end balance of the 50 state governments for 1991 fell to $5.9 billion, its lowest level since the 1982 recession. In 1989, this indicator of fiscal health was at $12.5 billion.

For fiscal 1992, half the states have proposed tax hikes that rank as the largest percentage increases in 20 years, and another ten states are expected to enact tax hikes. The immediate driving forces are cyclical--lower-than-projected revenues and higher-than-expected spending for aid to families with dependent children. Medicaid outlays also have been higher than anticipated. As the economic recovery strengthens in 1992, welfare spending should subside somewhat, but it is rather doubtful that health-care spending for the indigent will abate.

Several structural and regional problems will continue to plague state government budgets over the longer term. The aging population will be demanding more health care, and this will affect Sun Belt states such as Florida, Arizona, and California, all of which have large retirement communities. The recent "mini baby boom" will raise spending for education in order to build more elementary schools and hire teachers. The aging infrastructure (roads, bridges, dams, airports) will require replacing or improving. Overcrowded prisons have become an urgent problem in many states, and large amounts of construction spending to correct this problem are anticipated in the early 1990s.

In the 18-state First Interstate Territory, five states--California, Arizona, Utah, Texas, and Iowa--ran "temporary deficits" in fiscal 1991 and expect the same in 1992.

TAX SOURCES IN FI TERRITORY
(Percent of total revenues, fiscal 1990)

	Personal Income	General Sales	Property Tax
AK	0.0	3.0	35.1
AZ	**14.5**	**34.8**	**31.1**
CA	23.3	25.7	27.9
CO	**20.9**	**25.8**	**35.8**
HI	25.2	37.1	14.3
ID	**22.2**	**26.0**	**28.3**
IA	22.7	18.5	38.6
LA	**9.8**	**38.9**	**16.2**
MT	19.7	0.0	43.5
NV	**0.0**	**31.7**	**23.1**
NM	13.7	39.5	11.1
ND	**12.3**	**23.1**	**30.1**
OR	29.0	0.0	47.1
SD	**0.0**	**34.7**	**40.7**
TX	0.0	29.9	38.7
UT	**25.8**	**29.0**	**37.4**
WA	0.0	48.4	29.1
WY	**0.0**	**19.3**	**44.7**

Source: The Corporation for Enterprise Development

Sources of Tax Revenue More Balanced in Some States

An important measure of a state's business climate is its tax structure. Given the intense competition among the economic development agencies of the fifty states, it is instructive to evaluate the mix of tax sources in FI Territory. Six states (Alaska, Nevada, South Dakota, Texas, Washington, and Wyoming) have no personal income tax. Four of these states depend disproportionately on property taxes: Wyoming (44.7%), South Dakota (40.7%), Texas (38.7%), and Alaska (35.1%). Nevada and Washington derive their largest shares of total revenue from the general sales tax.

The states with the most favorable distribution of revenue sources are California, Colorado, Idaho, and Utah. These states are best positioned to regain fiscal stability in 1992-93.

NONFARM PAYROLL EMPLOYMENT

	1990		1991e		1992f		1993f	
	Thousands	% Change	Thousands	% Change	Thousands	% Change	Thousands	% Change
Alaska	237	4.5	240	1.2	243	1.2	248	2.1
Arizona	1,491	2.5	1,527	2.4	1,575	3.2	1,624	3.1
California	12,873	2.4	12,843	-0.2	13,023	1.4	13,348	2.5
Colorado	1,518	2.4	1,550	2.1	1,586	2.3	1,633	3.0
Hawaii	527	4.4	536	1.6	547	2.1	561	2.6
Idaho	386	5.5	400	3.7	412	2.9	425	3.1
Iowa	1,224	2.0	1,237	1.0	1,259	1.8	1,287	2.2
Louisiana	1,594	3.6	1,624	1.9	1,653	1.8	1,686	2.0
Montana	297	2.2	301	1.2	307	1.9	313	2.0
Nevada	624	7.4	640	2.5	662	3.5	689	4.0
New Mexico	575	2.3	581	1.0	590	1.6	602	2.0
North Dakota	266	2.0	269	1.4	272	1.0	277	1.9
Oregon	1,248	3.2	1,266	1.4	1,298	2.5	1,339	3.2
South Dakota	289	4.5	297	3.1	304	2.4	312	2.6
Texas	7,033	2.8	7,128	1.4	7,264	1.9	7,437	2.4
Utah	723	4.6	752	4.0	781	3.9	811	3.7
Washington	2,155	5.0	2,191	1.6	2,248	2.6	2,324	3.4
Wyoming	199	3.1	201	1.3	204	1.1	207	1.8
FI Territory	33,259	1.0	33,583	1.0	34,228	2.6	35,124	3.2
U.S.	109,971	1.5	108,947	-0.9	110,137	1.1	112,221	1.9

PERSONAL INCOME

	1990		1991e		1992f		1993f	
	$ Billions	% Change	$ Billions	% Change	$ Billions	% Change	$ Billions	% Change
Alaska	11.9	6.0	12.6	5.7	13.3	5.7	14.2	6.6
Arizona	58.9	5.9	62.8	6.5	67.2	7.1	72.0	7.1
California	619.4	7.4	636.7	2.8	673.7	5.8	717.4	6.5
Colorado	62.4	7.0	66.1	6.0	70.3	6.4	75.3	7.0
Hawaii	22.7	11.0	24.1	6.5	25.9	7.2	27.7	7.3
Idaho	15.4	9.0	16.5	7.2	17.6	6.7	18.8	6.4
Iowa	47.9	6.7	49.5	3.5	52.5	6.1	55.7	6.0
Louisiana	61.2	7.8	64.5	5.3	68.0	5.4	71.5	5.2
Montana	12.2	5.7	12.8	5.2	13.6	6.1	14.4	5.8
Nevada	23.3	11.4	24.9	6.9	26.9	7.9	29.0	8.0
New Mexico	21.7	7.1	22.8	5.1	24.1	5.9	25.5	5.9
North Dakota	9.7	7.1	10.2	5.6	10.8	5.5	11.4	5.9
Oregon	49.2	8.3	51.8	5.3	55.2	6.6	59.0	6.9
South Dakota	11.0	9.7	11.8	7.3	12.6	6.8	13.4	6.6
Texas	285.1	8.2	301.3	5.7	320.6	6.4	341.4	6.5
Utah	24.2	8.6	26.1	7.9	28.1	7.7	30.3	7.7
Washington	92.2	9.2	96.3	4.5	102.6	6.5	109.7	6.9
Wyoming	7.4	7.8	7.8	5.8	8.2	5.2	8.7	5.9
FI Territory	1,435.8	7.8	1,498.9	4.4	1,591.4	6.2	1,695.7	6.6
U.S.	4,662.7	6.5	4,816.6	3.3	5,081.5	5.5	5,381.3	5.9

Note: Calculations based on unrounded data.

First Interstate Bancorp

FORECAST 1992-1993

UPDATE

February 1992
First Interstate Territory Edition

First Interstate Bancorp

Contents

Overview	1
The U.S. Economy	2
Industry Perspective	6
Financial Institutions	8
The International Economy	9
First Interstate Territory	11

BANKING AFFILIATES

California
First Interstate Bank of California
First Interstate Bank, Limited
First Interstate Bancard Co., N.A.

Northwest
Alaska
First Interstate Bank of Alaska, N.A.
Idaho
First Interstate Bank of Idaho, N.A.
Montana
First Interstate Bank of Montana, N.A.
Oregon
First Interstate Bank of Oregon, N.A.
Washington
First Interstate Bank of Washington, N.A.

Southwest
Arizona
First Interstate Bank of Arizona, N.A.
Colorado
First Interstate Banks of Denver, N.A., and Englewood, N.A.
Nevada
First Interstate Bank of Nevada, N.A.
New Mexico
First Interstate Bank of New Mexico, N.A.
Utah
First Interstate Bank of Utah, N.A.
Wyoming
First Interstate Bank of Wyoming, N.A.

Texas
First Interstate Bank of Jacksonville
First Interstate Bank of Texas, N.A.

BANK LICENSEES

Colorado
First Interstate Banks of Arvada, N.A., Centennial, N.A., Golden, N.A., and Westminster, N.A.
First Interstate Bank of South Fort Collins
First Interstate Bank of Fort Collins, N.A.

Iowa
First Interstate Banks of Des Moines, N.A., Iowa - North, Iowa - Northwest, N.A., Fort Dodge, Greenfield, Kalona, Marengo, Sigourney, Sioux City, Urbandale

Louisiana
First Interstate Bank of Southern Louisiana

Montana
First Interstate Banks of Billings, N.A., Billings Heights, Colstrip, Hardin, Miles City, Missoula, N.A., and West Billings

North Dakota
First Interstate Bank of Fargo, N.A.

South Dakota
First Interstate Bank of South Dakota, N.A.

Wyoming
First Interstate Bank of Commerce

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Abu Dhabi
Bangkok
Beijing
Hong Kong
Jakarta
Lima
London
Madrid
Manila
Mexico City
Rio de Janeiro
Seoul
Shanghai
Singapore
Sydney
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Overview

In recent months, millions of households and businesses have bet that the economy will strengthen. Home refinancing soared in the final months of 1991 in anticipation of rising interest rates as economic activity revives. Simultaneously, new debt issuance by corporations rose dramatically. Maturities of new debt of 30 and 40 years imply that long-term interest rates are not expected to go much lower.

Financial Markets Point to Growth

The expectation that interest rates will rise as the year progresses is already affecting home sales. With the lowest mortgage rates in many years, the "affordability" of homes is the best in 18 years and not likely to get any better. Even in a soft economy, house prices in 1991 kept up with inflation. Homeowners will experience larger wealth gains in 1992.

Housing starts are forecast to rise by over 20% in 1992. In addition to creating construction jobs, a stronger housing sector will restore consumer confidence and boost household net worth. A pickup in consumer spending on both durable and nondurable goods will account for much of the faster growth of real gross domestic output.

Business investment spending is also slated to rise in 1992 by more than the rate of inflation. Even in an atmosphere of gloom about the national economy, a survey of business projected an increase in capital spending of 5% this year. Such surveys traditionally underestimate the strength of investment spending in the early stages of recovery.

Central Bank "Pump Priming"

Growth of total bank reserves jumped sharply in the final few months of last year as the Federal Reserve aggressively sought lower short-term market interest rates. Various measures of money and bank credit responded to the injection of reserves and will fuel faster spending growth this year.

The dramatic interest-rate cuts by the Fed in December should be seen as an "insurance policy" that enough monetary stimulus will promote stronger growth without fiscal action. While the Administration and Congress appear anxious to enact a fiscal package so they can take credit for the recovery, our forecast of faster growth of output and employment does not depend on any of the new fiscal steps recently proposed.

On the contrary, a risk to the near-term outlook is that a short-sighted election year dose of fiscal stimulus will heighten expectations about future inflation and push up longer-term interest rates. Such a result would inhibit the emerging strength in the housing and investment sectors.

As this year progresses, the key to the sustainability of the expansion is the credibility of the central bank's commitment to ultimate price stability. That will require allowing short-term interest rates to rise as credit demands build in order to restrain bank-reserve and money-supply growth. Any sign that the monetary authorities have placed an artificial ceiling on short-term interest rates would raise the inflation premium in longer-term maturities, driving up their yields.

Winning Industries in the 1990s

Although many industries are experiencing secular difficulties not associated with the general downturn of the business cycle, several sectors are poised to grow readily with the expanding economy. Producers of pollution control devices and environmental services should see strong growth, given the recent explosion in environmental regulations. High technology industries such as pharmaceuticals, biotechnology, and computer software will benefit from increased government attention to commercial R&D efforts, the enforcement of intellectual property rights globally, and a favorable capital-investment environment. Finally, many manufacturing industries, which have shown marked increases in productivity and efficiency in the last decade, are well positioned to compete effectively in the global business environment of the 1990s.

Return of the Latin Export Market

Exports will also be a relatively strong area for the U.S. economy. Several Latin American economies have begun a new period of rapid economic growth in the early 1990s, the result of economic reforms undertaken over the past few years. The newly industrialized economies of East Asia have also provided an important growth market for American exporters, a trend likely to continue. At the same time, although European growth is slow in the near term, by 1993 exporters will also find an expanding market across the Atlantic. Although the dollar may rise somewhat during the next two years, it will still be at levels that will encourage exporting.

West Is Best

With the exception of California, the western part of the country escaped the brunt of the national recession. Looking forward, while California will about match the nation's performance in 1992-93, other states in the West will grow faster than the nation as a whole. Idaho and Utah are expected to continue to be among the fastest growing states in the country. Arizona, Colorado, and Texas will continue to recover from the depressed conditions of the late 1980s. The Pacific Northwest will record further gains as it attracts both new residents and jobs.

February 18, 1992

The U.S. Economy

The U.S. economy dropped sharply in the first part of 1991, showed signs of recovery, and then stalled in the latter part of the year. For 1991 as a whole, domestic output was 0.7% below the level of 1990, the first decline since 1982. Housing starts plunged for their weakest reading in 46 years. Auto and truck sales sank to their lowest level since 1983. Profits dropped in most industries, while unemployment rose.

A striking divergence between Main Street and Wall Street became evident at the end of 1991, however. While consumer confidence surveys revealed continuing pessimism, the stock market moved to all-time highs. Which assessment of the economy is correct? We believe that the stock market is the more forward-looking barometer and will be validated by an improving trend of economic activity and consumer confidence over the course of 1992.

Favorable Factors in Place

Several positive forces have now converged to set the stage for a resumption of economic growth during the next several months:

(1) Balance sheets have strengthened throughout the economy. Consumers and businesses have slowed their use of debt, and corporations are raising new equity. Asset values have improved in both the household and business sectors, with rising stock prices and stable or higher home prices. Financial institutions have enhanced their asset quality by shedding nonperforming loans and have also increased their capital ratios.

(2) Lower interest rates will bolster economic activity in two important ways. First, households and companies are realizing an increase in their net cash flow as interest payments on variable-rate loans fall. These gains in cash flow will help spur spending over time. Many consumers with home-equity loans and business firms with short-term borrowings are realizing a significant benefit. Individuals have seized the opportunity to refinance their homes to reduce their monthly payments or pay off their mortgages in a shorter time period. Applications for mortgage refinancing quadrupled in the last six months of 1991.

Second, the amount of borrowing by consumers and business firms will gradually respond to the lower level of interest rates. Interest rates on autos, mobile homes, and home equity loans have come down. Lower interest rates also mean a lower investment "hurdle rate" for business and will make more outlays profitable.

(3) Bank reserves are expanding rapidly, with 15-20% annual rates of growth over the past three months. We expect M2 (currency, checking, savings, money market accounts, and small certificates of deposit) to increase twice as fast as the rise of only 2.7% in 1991. This acceleration in monetary growth should foster higher income and spending gains fairly quickly, with results in the first half of 1992.

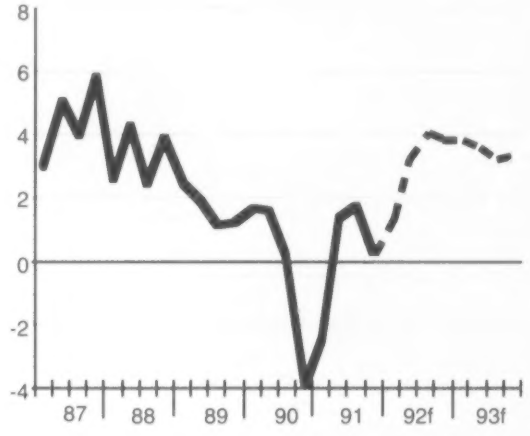
(4) Oil prices have dropped to around $19 a barrel (end of January) in terms of the West Texas Intermediate benchmark, about one half the peak reached during the Gulf crisis in the latter part of 1990. The wealth loss suffered during the Gulf conflict has thus been reversed.

(5) Inflation has subsided to the 3% level, which is helping to hold interest rates down and is also allowing individuals to realize gains in real earnings, as incomes rise faster than prices.

Following 1991's weak performance, we expect real gross domestic product (GDP) to advance 3.2% (fourth quarter to fourth quarter) in 1992 and 3.6% in 1993. Most sectors and regions of the economy should be participating in the recovery by the end of this year.

Real GDP Strengthens

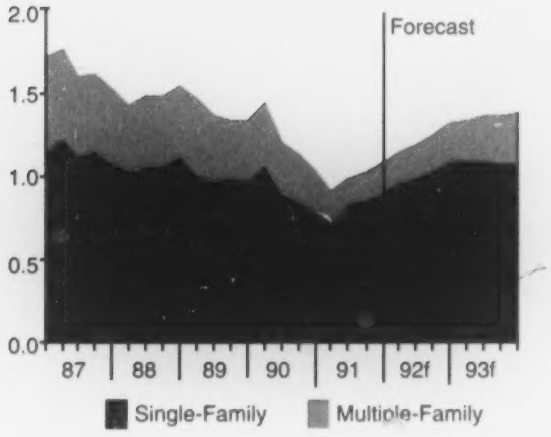
(Percent change from prior quarter, annual rate)



Housing and real estate will be the leading edge of better economic performance in 1992. As potential homebuyers are sensing a bottoming out of mortgage rates and home prices, sales of new and existing homes are moving higher. Home construction will advance, as household formation has outstripped building in many markets during the past two years. Although commercial banks will be cautious in lending to builders, individual investors, joint ventures, and pension funds will be attracted to the higher returns in the construction industry. We expect housing starts to advance by 21% in 1992 to 1.23 million units, with another 10% gain in 1993 to 1.36 million units. The gain in new home construction will have ripple effects through various supplier industries, ranging from wood to glass, and will also feed through to the home furnishings industry.

Housing Leads the Recovery

(Millions of units, annual rate)



Consumer spending will gradually improve as layoffs abate and confidence resumes. With retail sales during 1991 posting their smallest gain in 30 years (0.7%), a considerable pent-up demand for durable and nondurable goods has accumulated. Our forecast is for sales of autos and light trucks to increase about 8% in 1992 to 13.3 million units, while vehicle sales should reach 14.0 million in 1993.

Although inventories bulged for brief periods during 1991 in some sectors, such as autos, companies have generally kept a tight lid on stocks of goods. As sales pick up, efforts to rebuild inventories will give a secondary boost to the economy.

Exports have held up quite well, mitigating the impact of sluggish domestic spending. Slower growth in Germany and Japan will limit gains in U.S. sales abroad during the coming year, but exports should still perform quite well. Impressive strides by Mexico, some improvement in other Latin economies, and ongoing gains in the newly industrialized economies of the Far East will generate markets for American goods. The dollar is also at a level that will render U.S. products competitive in most markets.

Capital spending generally lags the rest of the economy in both downswings and upswings, and 1992 is unlikely to differ markedly from that pattern. Business spending for new equipment is likely to gather momentum in the second half of this year, as firms take advantage of lower hurdle rates and stronger cash flows to update their operations and make their facilities more competitive.

Infrastructure building will be strong in 1992-93, with construction work on roads, highways, rapid transit, water systems, and airports. Specially earmarked tax receipts or bond funds will support this public construction.

Some Shadows Remain

A few economic segments will not share in the general process of economic improvement. The downsizing of defense will continue, although technical research will be largely spared. Private nonresidential construction will decline, as few new office, hotel, shopping center, or industrial projects are launched. State and local government spending is also likely to show only limited growth during the next two years because of the stress on budgets faced at all levels.

Jobs and Profits

After 1-1/2 years of job losses, we expect employment to post a moderate gain of 1.6 million in 1992, followed by another increase of 2.8 million jobs in 1993. The unemployment rate probably peaked at 7.1% in December 1991 and is projected to recede to 6.3% by the end of 1992 and 5.3% by the end of 1993.

Corporate profits have been hammered by the recession, with 1992 results showing a third consecutive annual drop. We expect after-tax "economic profits" (excluding inventory gains and valuing depreciation on a replacement-cost basis) to advance 9% in 1992 and 12% in 1993.

Risks from Washington

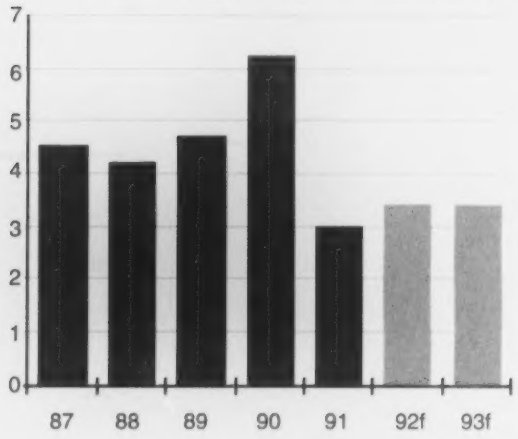
As suggested above, we believe the forces are in place to support better economic performance in coming months without additional fiscal stimulus. A substantial package of tax cuts and/or spending increases could exacerbate fears in the bond market regarding the deficit and future inflation. The federal budget deficit for fiscal 1992 is likely to be about $360 billion even without any changes in fiscal policy. A significant rise in mortgage and other long-term interest rates could scuttle the recovery in housing and business capital spending. Tax cuts and spending increases offset by defense cuts could also be counterproductive. The weakest regions of the country remain New England and California, areas especially dependent on defense.

Inflation Down, Interest Rates To Rise

We expect inflation to stay down even as the recovery takes hold. Inflation trends in 1992 and 1993 will reflect the continued low monetary growth rates of 1990 and 1991. We also expect oil prices to remain moderate, averaging about $19.00 a barrel in 1992 and $19.50 in 1993. As a result, consumer prices, which increased 3.0% in 1991 (fourth quarter to fourth quarter) are forecast to rise 3.4% in both 1992 and 1993.

Inflation Subdued

(Percent change, 4th quarter to 4th quarter)

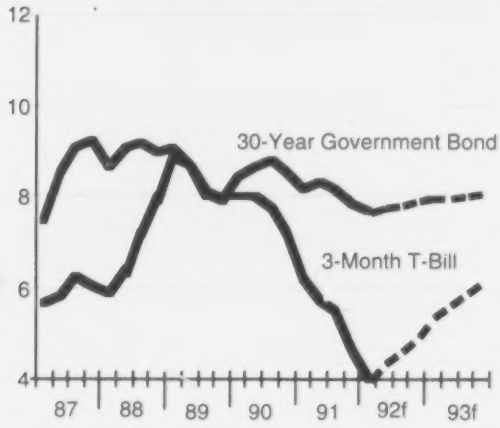


Interest rates have probably reached their lows for the current cycle. Short-term interest rates mirror the strength or weakness of the economy and will rise gradually as the economy shows a stronger performance. The Federal Reserve controls the federal funds rate, but that control is not without limitation. If the Fed were to attempt to hold the funds rate down while credit demands were increasing with an advancing economy, money growth would accelerate. Intermediate and long-term interest rates would rise on the expectation of rising interest rates in the future because of higher inflation.

We believe the Federal Reserve will wait in the first part of 1992 until convincing news of a strengthening economy has developed before taking any action. The Fed will then allow the federal funds rate target to move up about one percentage point to 5% by year-end 1992. Another percentage point rise can be expected by year-end 1993. Although this advance sounds substantial, it is important to remember that the funds rate was above 6% only a year ago in the first part of 1991. Both the futures market and the steepness of the yield curve suggest that the financial markets also believe that short-term rates will rise in the next two years.

Short-Term Yields Rise Relative to Long-Term Rates

(Quarterly average, percent, bond-equivalent yields)



Long-term interest rates typically move in the same direction as short-term rates, although such co-movements are not inevitable. With inflation remaining below 3.5%, the yield on 30-year Treasury bonds is unlikely to return to the 9-10% range during the next two years. We expect a rise from a low of 7.4% early in 1992 to a level approaching 8% by the end of this year and to slightly over 8% in 1993.

Mortgage rates on 30-year fixed rate loans fell to a low of about 8.25% early in 1992 and are likely to approach 9% by the end of this year, remaining slightly over 9% through 1993. Rates at those levels would still be consistent with a significant upturn in housing.

FORECAST OF INTEREST RATES

(Quarterly averages)

	1991				1992				1993			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Short-Term	Actual				Forecast							
Fed Funds (Overnight)	6.43	5.86	5.64	4.82	4.04	4.42	4.70	4.98	5.38	5.67	5.92	6.17
Treasury Bills (3-month)[1]	6.02	5.56	5.38	4.54	3.88	4.27	4.55	4.83	5.23	5.52	5.77	6.02
CDs (3-month, secondary)	6.71	6.02	5.70	4.91	4.12	4.52	4.80	5.08	5.48	5.77	6.02	6.27
Eurodollar (3-month)	6.76	6.04	5.72	4.93	4.14	4.54	4.82	5.10	5.50	5.79	6.04	6.29
Prime Rate	9.19	8.67	8.40	7.60	6.50	6.75	7.00	7.17	7.67	8.00	8.29	8.50
Long-Term												
U.S. Government Bonds (30-yr)[2]	8.20	8.32	8.18	7.85	7.66	7.77	7.83	7.93	7.98	8.03	8.08	8.12
Corporate Aaa (Moody's)	8.93	8.91	8.79	8.45	8.28	8.29	8.29	8.39	8.44	8.50	8.57	8.63
Mortgage Rate (Fixed)[3]	9.50	9.53	9.28	8.69	8.61	8.69	8.79	8.93	9.02	9.08	9.15	9.20

(1) Bank discount basis. (2) Yields adjusted to constant maturities. (3) Contract rates on first mortgages, conventional market.

MAJOR ECONOMIC INDICATORS

	QUARTERLY												4th QUARTER					
	1991				1992				1993					% Change		% Change		% Change
	I	II	III	IV	I	II	III	IV	I	II	III	IV	1991	'91/'90	1992	'92/'91	1993	'93/'92
	Actual				Forecast				Forecast				Actual		Forecast			
GROSS DOMESTIC PRODUCT (Billions of $, annual rate)	5589	5653	5709	5737	5797	5887	5984	6082	6181	6279	6376	6473	5737	3.2	6082	6.0	6473	6.4
% Change, annual rate	2.3	4.6	4.1	1.9	4.3	6.3	6.8	6.7	6.7	6.5	6.3	6.2						
REAL GDP (Billions of 1987 $, a.r.)	4824	4841	4863	4866	4884	4924	4975	5022	5071	5117	5159	5203	4866	0.2	5022	3.2	5203	3.6
% Change, annual rate	-2.5	1.4	1.8	0.3	1.5	3.3	4.2	3.9	3.9	3.7	3.3	3.5						
REAL FINAL DOMESTIC SALES* (Billions of 1987 $, a.r.)	4872	4881	4894	4875	4890	4925	4970	5014	5057	5099	5137	5177	4875	-0.9	5014	2.8	5177	3.3
% Change, annual rate	-3.7	0.7	1.0	-1.5	1.2	2.9	3.7	3.5	3.5	3.4	3.0	3.2						
REAL CHANGE IN INVENTORIES (Billions of 1987 $, a.r.)	-33	-30	0	3	2	5	9	12	16	18	20	23	3	N/A	12	N/A	23	N/A
GDP DEFLATOR (1987=100)	115.9	116.8	117.4	117.9	118.7	119.6	120.3	121.1	121.9	122.7	123.6	124.4	117.9	3.0	121.1	2.7	124.4	2.7
% Change, annual rate	5.0	3.1	2.1	1.7	2.8	2.9	2.5	2.7	2.7	2.7	2.9	2.6						
CONSUMER PRICE INDEX (1982-84=100)	135.0	135.7	136.7	137.7	138.8	139.9	141.2	142.4	143.5	144.7	145.9	147.2	137.7	3.0	142.4	3.4	147.2	3.4
% Change, annual rate	3.6	2.1	3.0	3.0	3.4	3.5	3.1	3.3	3.3	3.3	3.5	3.4						
AUTO SALES (Millions, annual rate)	8.3	8.4	8.6	8.2	8.4	9.1	9.4	9.5	9.6	9.7	9.8	9.7	8.4**	-11.7	9.1**	8.5	9.7**	6.6
HOUSING STARTS (Millions, annual rate)	0.92	1.00	1.04	1.09	1.15	1.19	1.26	1.33	1.35	1.36	1.36	1.37	1.01**	-15.2	1.23**	21.8	1.36**	10.4
INDUSTRIAL PRODUCTION (1987=100)	105.8	106.4	108.1	108.0	108.2	109.0	110.3	111.7	113.0	114.3	115.5	116.8	108.0	-0.5	111.7	3.4	116.8	4.6
% Change, annual rate	-9.6	2.3	6.5	-0.4	0.6	3.1	4.9	5.1	4.8	4.7	4.4	4.4						
NONFARM EMPLOYMENT (Millions)	109.2	108.8	109.0	108.9	109.0	109.4	109.9	110.5	111.2	112.0	112.7	113.4	108.9	-0.8	110.5	1.5	113.4	2.5
UNEMPLOYMENT RATE, CIVILIAN (Percent)	6.5	6.7	6.8	6.9	7.0	6.8	6.6	6.4	6.1	5.8	5.6	5.4	6.9	N/A	6.4	N/A	5.4	N/A
ECONOMIC PROFITS AFTER TAXES (Billions of $, annual rate)	183	180	178	178e	182	192	202	208	210	217	223	232	180e**	-2.2	196**	9.2	220**	12.4
% Change over year ago	-9.9	-10.8	10.2	5.3	-0.6	6.9	13.9	16.9	15.8	12.5	10.4	11.4						
MONEY SUPPLY M2 (Billions of $, a.r.)	3354	3393	3394	3416	3447	3500	3549	3599	3649	3695	3741	3785	3416	2.7	3599	5.4	3785	5.1
% Change, annual rate	3.5	4.8	0.0	2.6	3.7	6.3	5.7	5.8	5.6	5.2	5.0	4.8						

NOTE: All quarterly series are seasonally adjusted; % change, annual rate calculated from prior quarter; calculations based on unrounded data; a.r. = annual rate; e = estimate. *Excluding Commodity Credit Corp. purchases

**Annual total; N/A = Not applicable

Industry Perspective

Several conditions are in place that will allow some sectors of U.S. industry to respond quickly as the economy gains strength in 1992. Recent reductions in interest rates, for example, have produced a surge of new corporate debt issues. Lower interest rates will enable many firms with high debt levels from the 1980s to reduce their interest burden, allowing more cash flow to be devoted to capital investment, research and development, and other outlays to increase competitiveness. Greater efficiency and productivity, especially in the manufacturing sector, will help make American industry more competitive internationally over the next several years. Meanwhile, although the dollar may trend upward, it should remain in a range that will boost exports in 1992 and 1993.

Industry must also be prepared to adapt to changes in the nature of the U.S. economy in the coming years. Evolving consumer attitudes will require a greater shift toward "value-oriented" merchandising in such industries as retail trade, food processing, apparel manufacture, and many personal and business services. In addition, many industries will experience higher mandated costs through 1993, as compliance deadlines for various government regulations are met. Stricter environmental, product-quality, and worker health and safety regulations will pose significant challenges to business. Firms in the oil and gas, chemical, food processing, electric utility, and mining industries, for example, will be particularly affected by new federal and state regulations.

While many industries will recover with the overall economy, certain segments have been impeded by non-cyclical factors in the last few years. The forest products industry, for example, has been beleaguered by environmentalists and has seen drastic reductions in the available supply of harvestable timber in the Pacific Northwest. Industries such as autos, paper products, chemicals, and retail trade, meanwhile, face difficulties associated with excess productive capacity.

As in all recoveries, certain industries will lead the current expansion while others will merely "muddle through" or even continue to decline. A few of the industries that will lead the recovery in 1992 and 1993 are discussed below, while some of those that will not fare as well are also examined.

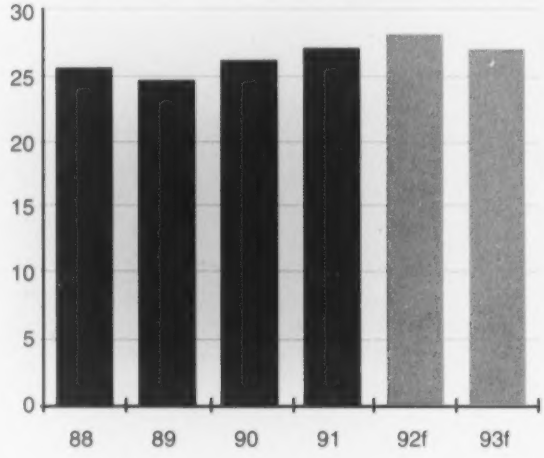
Leading the Recovery...

Infrastructure and Home Construction

With the authorization of federal funds under the recent transportation bill, many states will begin construction on various infrastructure projects in 1992 and 1993. Spending to repair or build roads, bridges, airport facilities, schools, and prisons over the next several years will provide opportunities for construction companies that cannot find jobs building hotels, malls, offices, and other overbuilt commercial facilities.

Infrastructure Spending on the Rise

(Real federal outlays, in billions of 1990 dollars)



With mortgage rates at their lowest level in many years, demand for new housing will increase over the next several months. Although housing starts for all of 1991 were at their lowest level in over 40 years, sales increases in December and in the early part of this year seem to indicate that buyers are moving back into the market. This should provide some growth in revenues for home builders in 1992 and 1993, as consumer confidence recovers along with a stronger economy. Real estate and construction should also receive some boost from a fiscal package that may emerge from Congress in 1992.

Software and Computer Services

The software industry escaped the recent slowdown in the economy largely unscathed and was one of the fastest growing industries during 1991. Software producers should continue to experience steady growth over the near term, as companies attempt to maximize the value of recent investments in computer hardware. Productivity-enhancing programs, and network and systems-integration software are likely to provide the most growth for the industry.

The trend toward outsourcing of computer-related activities will continue over the foreseeable future. The high cost and rapidly changing nature of the technology, as well as the difficulty of maintaining specialized staff to handle computer operations, will lead many companies to employ outsourcing firms in the next several years. Electronic data interchange services will also show strong growth as more

industries, as well as government, realize the efficiencies inherent in "paperless" ordering, invoicing, and other trade-related activities. Firms specializing in computer training and systems design should also do well in 1992. The computer services industry is likely to experience annual real growth of over 10% during the next several years.

Pharmaceuticals

Drug manufacturing, another industry that was relatively unaffected by the recession, should see continued strong growth in revenues and earnings through 1993. Exports, which are a significant component of sales, will continue to improve, especially given expectations of only a moderate rise in the dollar over the next two years. Smaller, R&D-intensive start-ups (such as biotech firms) may face difficulties in acquiring the capital needed to bring their products to market, but mergers and strategic alliances with large, established drug makers should allow most to continue operating. Also, pricing will continue to come under pressure over the next few years as the government and health insurers seek to control expenditures on medical care.

Pollution-Abatement and Environmental Services

With the approach of compliance deadlines under the 1990 Clean Air Act amendments, and with the implementation of stricter environmental quality standards in many states (such as California), firms specializing in pollution-abatement products and environmental services should experience healthy demand in 1992 and 1993. Many firms in industries such as chemicals, oil refining, mining, and electrical utilities will need to undertake capital expenditures to reduce air and water-borne emissions. In some cases, facilities will be shut down and/or will require cleanup. This should result in greater revenues both for companies that manufacture emission-control devices and for those specializing in environmental consulting and site cleanup services.

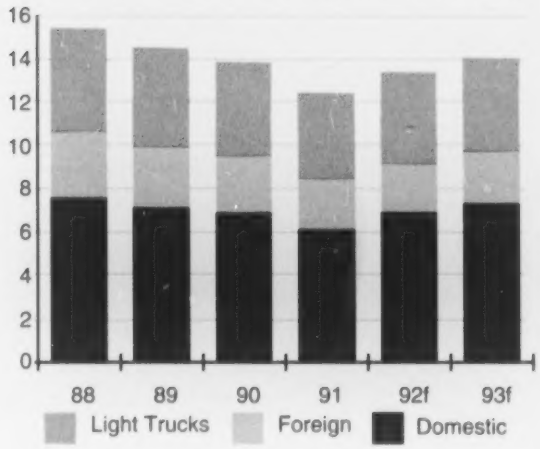
Lagging the Recovery...

Autos

In 1991, Detroit's Big Three (GM, Ford, Chrysler) posted a combined operating loss in excess of $6 billion. Sales of Japanese imports and "transplants" also weakened as the year wore on. Job losses and general anxiety over the economy contributed to the worst year for U.S. auto sales since the early 1980s. Even as the recovery begins to gain strength and auto sales recover modestly in 1992, U.S. auto makers will be forced to continue to reduce costs and excess capacity. Collectively, the Big Three may post another year of negative operating income in 1992 (although not nearly as great as in 1991), but are likely to return to profitability by 1993.

Slow Recovery in Auto Sales

(U.S. car and light truck sales, in millions of units)



Retail

Annual retail sales growth has slowed progressively in every major category (nondurable goods, autos, and non-auto durable goods) during the past three years. This has been due in part to a retrenchment in consumer attitudes and spending patterns after the rapid growth of the 1980s. As debt-laden consumers seek more value for their dollar, some retailers that pursue "value-merchandising" strategies have been able to expand despite the overall weakness in the industry. Not withstanding these successes, the industry will consolidate further in 1992, with a sizable number of closures and bankruptcy filings continuing at least through the first half. As consumer confidence is restored later in the year, pent-up demand should result in stronger growth in sales and earnings for those firms that remain in the industry.

Chemicals

Although chemical makers will benefit this year from generally lower materials costs, they will be slowed in their recovery by an overhang of productive capacity that lingers from the late 1980s. Primarily because natural gas and oil prices are likely to remain relatively moderate and stable, U.S. producers (who use gas and oil products as both fuel and feedstock) will experience a roughly 2% reduction in raw-materials prices this year. In addition to excess capacity, increasing costs related to stricter environmental regulations and site cleanup will restrain growth in the industry in 1992 and 1993. Demand, however, should begin to strengthen this year and next as industrial production picks up in a number of areas of the economy.

Financial Institutions

Banking Reform in Small Steps

Expectations that Congress would enact comprehensive reform legislation aimed at modernizing the U.S. banking industry were dashed at the end of 1991. Instead, Congress opted for passage of a narrow banking bill that focused on recapitalizing the Federal Deposit Insurance Corporation (FDIC) and also tightened the regulatory process. While the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) contains a few positive features, the overall thrust reflects the legacy of the thrift crisis, the influence of special interest groups, continuing concern over bank failures, and the prolonged recession. Failure to allow interstate branching and grant expanded powers to banks will mean that the inequities that banks face will persist in the near term.

The FDICIA confers new powers on federal banking agencies with respect to "undercapitalized" banks. Some loss of discretion and flexibility accompanies this expansion of regulatory authority, in that prompt action must be taken to resolve situations where institutions' capital/asset ratios have declined to 2% or less. Strict adherence to the new rules will mean that, over time, forbearance in dealing with weak banks will no longer be applied. Banks will pay greater attention to their capital positions in formulating their growth strategies, as "well-capitalized" banks will be subject to less burdensome examinations and compliance requirements.

The FDIC's funding capacity has been enhanced in two specific ways: (1) its borrowing authority from the Treasury has been increased from $5 billion to $30 billion; and (2) it has been authorized to impose on banks emergency special assessments in addition to regular assessments needed to repay the Treasury or rebuild reserves. In 15 years, the FDIC is required to return to a coverage level of $1.25 per $100 of insured deposits (currently near zero). The FDIC has also been mandated to develop a new system of risk-based insurance premiums by the end of 1992.

The new legislation dealt a death blow to the "too-big-to-fail" approach to resolving failed institutions. After 1994, the FDIC is prohibited from taking any actions to reimburse depositors for more than their insured deposits, or to protect foreign depositors and other creditors. Also, the Federal Reserve's discount window facility will be limited for weak institutions, thus restricting its "lender of last resort" role. The phasing-in of this new approach in 1992-93 should improve market discipline on the part of depositors as well as reduce the FDIC's exposure to loss.

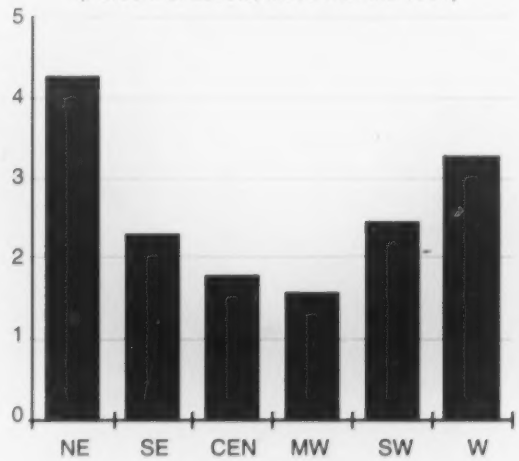
Controversy over the cost of bailing out the nation's troubled banks can be expected to heat up in 1992. The latest Administration estimate is $60 billion over the next five years, while the Congressional Budget Office's estimate is $44 billion. Some private groups have predicted a total bailout cost ranging as high as $120 billion on the basis of the number of troubled banks with assets over $1 billion. In this atmosphere, the FDIC is not likely to run into much resistance in raising its assessments effective mid-1992, thus increasing further a bank expense item that has already been raised by nearly 300% since 1989. Such action is certain to increase the incentive for large banks to shift to non-deposit funds and to foreign branch deposits.

Credit Quality To Improve

Nonperforming assets (NPAs) as a percent of total assets may have peaked in the first half of 1991 at 3.19%. For all commercial banks in the nation, the NPA ratio declined to 3.07% for the first nine months of 1991. Data for the largest banks covering the fourth quarter of 1991 indicate a continuing decline in the NPA ratio. As the economy recovers, real estate markets firm up, and banks continue an aggressive charge-off policy, a return to the 1988 NPA low of close to 2% is likely in the 1992-93 period.

The biggest NPA problems in 1991 were concentrated in the Northeast (4.3%) and the West (3.2%). These regions were hardest hit by the recession, especially the weakness in real estate markets. Banks in the Northeast had 8.4% and Western banks had 4.1% of their real estate loans in nonperforming status in the first nine months of 1991.

Nonperforming Assets Vary By Region
(Percent of assets, first 9 months 1991)



The regional disparity in credit quality—which directly affects the capital structure, profitability, and soundness of banks—points to the need for greater diversification of bank portfolios. Consequently, interstate branching is likely to be a priority issue for the banking industry again in 1992 or 1993.

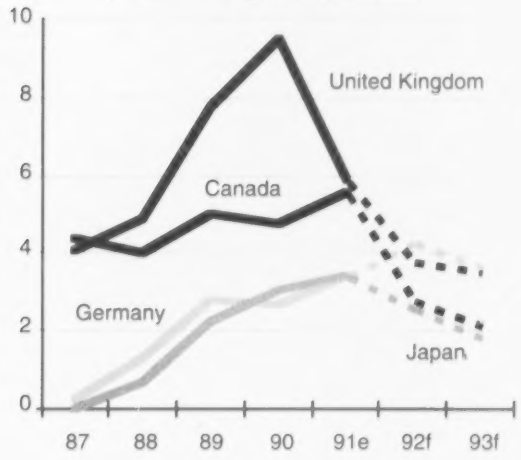
The International Economy

Growth to Pick Up in Second Half

Tight monetary policies in most major industrial economies are bringing about a period of slower economic growth. In Japan, the money supply in December was only 2% above its year-earlier level, the smallest increase on record. Economic activity decelerated during 1991, and a period of low growth is likely to continue during the first half of 1992. The Bank of Japan has lowered interest rates gradually since the middle of last year, following declines in equity and real estate prices. The Japanese economy is expected to pick up in the second half of this year, with a return to more vigorous growth in 1993. Inflation, which peaked early in 1991, has recently fallen to under 3% and is likely to remain subdued.

Inflation Rates Converge

(Percent change from prior year)



In Western Europe, economic activity remains sluggish, the result of very high real interest rates that have been a cost of German unification. The large budget deficit caused by subsidies to the eastern part of the country and the resulting government borrowing have put pressure on financial markets, while the Bundesbank has maintained a restrictive policy. By mid 1991, economic growth in the western part of Germany was flat, while the eastern part of the country had yet to begin a recovery. Inflation appears to have peaked last fall, allowing some room for an easing of monetary policy in coming months, although wage increases are likely to make this a gradual process. Nevertheless, monetary easing together with a rapid increase in investment in the east should bring about a revival of activity for the overall economy, with growth of 3% or more in 1993.

Because monetary policies throughout Western Europe are linked by exchange-rate policy, high real interest rates have been general, and economic growth has slowed substantially. Recessions have occurred in the United Kingdom, Switzerland, Sweden, and Finland, while growth elsewhere slowed to an annual rate of about 1% during the second half of last year. At the same time, inflation is converging and is likely to fall to under 4% in most major countries by the second half of this year. Exceptions may be Italy, Spain, Sweden, and Switzerland. The convergence of inflation is one of the prerequisites for monetary unification later in the decade as established late last year by the members of the European Community.

Canada, Australia, and New Zealand have also experienced recessions. Canada's economy should show a fairly robust rebound during the course of 1992, as monetary policy is eased and the U.S. economic recovery gets under way. An easing of Australian monetary policy has also set the stage for a return to moderate growth.

In general, the sectors that have slowed the most in the industrial countries are those that are interest sensitive, including housing and consumer durables. In the recovery, these sectors should be among the most rapidly growing.

Developments in Eastern Europe, C.I.S.

The severe declines in economic output experienced over the past two years in Eastern Europe are likely to come to an end during the forecast period. Last year alone, output is estimated to have plummeted anywhere from 7% in Hungary to 20% in Bulgaria. By the end of 1992, a return to positive growth is likely in Hungary and in Czechoslovakia, although inflationary pressures in the former may limit the pace of growth. In the republics of the Commonwealth of Independent States (C.I.S.), 1992 output will fall considerably, following last year's estimated 12% drop. In Russia, it has yet to be demonstrated that the government can control the inflation that has reached an annual rate of several hundred percent.

The financial position of these countries is a major constraint on their ability to establish viable currencies and to invest in the necessary economic restructuring. Thus, although the establishment of market economies over time will greatly increase the scope for trade, in the short run there remain major obstacles. Russia, managing the external debt that remains from the Soviet period, has been unable to meet all its external obligations, and commercial finance is unavailable to the country.

Latin America Returns

Among developing countries, a return to soundly based economic growth is occurring in Latin America. Economic reforms in Chile, Mexico, and Venezuela are already producing results in terms of foreign

investment and rising incomes. Colombia is also continuing the process of liberalization. In addition, although it is still early, reform in Argentina appears to be curing that country's long bout of triple-digit (or higher) inflation. Liberalization of trade regimes and more rapid economic growth mean that Latin America will once again be a growing market for American exporters after a decade during which the region's share of U.S. trade declined. Free trade with Mexico, should an agreement be ratified, would reinforce this trend and could be followed by agreements with other Latin American countries. Mexican real GDP growth this year is expected to be in the 6% range, with inflation falling to somewhere around 15%.

Although East Asian countries continue to be among the world's most rapidly growing economies, rising inflation and current-account deficits have meant a deceleration in the rate of growth in some countries. Indonesia, Korea, and Thailand all fit into this pattern; it is likely that all three will return to quite high rates of economic growth as the U.S. and Japanese economies revive.

Dollar Set To Rise

The U.S. dollar, after having risen substantially following the Gulf war, declined during the second half of 1990 against both the yen and the deutschemark. The downward trend in U.S. interest rates and slow growth in the economy made dollar investments less attractive *vis-à-vis* Japanese and European alternatives. As a result, the dollar fell by more than 10% from its mid 1991 high against the yen and by nearly 20% against the German currency.

Just after the turn of the year, however, the dollar began to rise fairly strongly, a trend that was halted by central bank intervention. The large and rising Japanese trade surplus—which became a political issue—prompted intervention to maintain a strong yen. Despite this intervention, fundamental forces now seem to favor the dollar. First, U.S. interest rates have passed their low point and from now on should be rising. In Japan, by contrast, it is unlikely that interest rates will rise during the first half of the year. In Germany, interest rates should begin to fall in coming months. Thus, interest rate differentials should favor the dollar. In addition, the onset of economic recovery in the United States also should be pro-dollar.

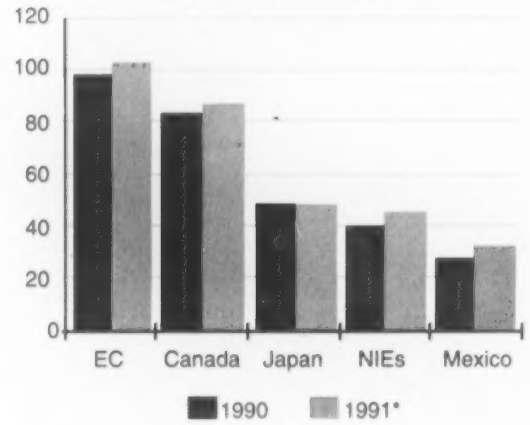
By the end of 1992, the dollar may move back up almost to the levels of mid 1991 against the Japanese currency, *i.e.*, approaching ¥140. Repeated intervention is a possibility, given the politicization of the bilateral trade relationship. In the case of the deutschemark, the dollar is unlikely to reach its mid 1991 peaks during 1992, but an increase to above DM 1.7 appears possible.

Moderate Rise in Trade Deficit

During 1991, the merchandise trade deficit is estimated to have fallen to $69 billion from the $108 billion recorded the previous year. Exports rose by about 7%, while imports declined 2%. The major factors behind these developments were a lower dollar and the recession in the United States, which both limited import demand. The relatively good performance of exports was led by shipments to Latin America and to the newly industrialized economies of East Asia. Exports to Mexico (the third largest export market) rose about 12%, while those to Venezuela skyrocketed more than 50%. The four East Asian economies purchased 12% more in 1991.

There are signs that U.S. export competitiveness is also improving in Europe. Recession in the United Kingdom meant that exports to that market fell last year, but exports to the rest of the European Community rose 9% despite a general slowing of economic growth. Exports to Japan, by contrast, were about unchanged.

Exports Do Well in Most Major Markets
(Billions of dollars)



*first 11 months annualized

The outlook is for a rise in the trade deficit in 1992 and 1993 as U.S. economic growth revives, bringing with it a return to rising imports. However, the rise in the deficit is expected to be relatively modest as exports continue to rise at a relatively good pace. Despite the considerable political attention being given to the trade deficit, its 1991 level was equivalent to only about 1.2% of GDP, not a high level by international standards and well below the peak of 3.5% reached in 1987. Only a slight rise in this ratio from its 1991 level is expected through the forecast period, as the deficit is forecast to remain under $100 billion.

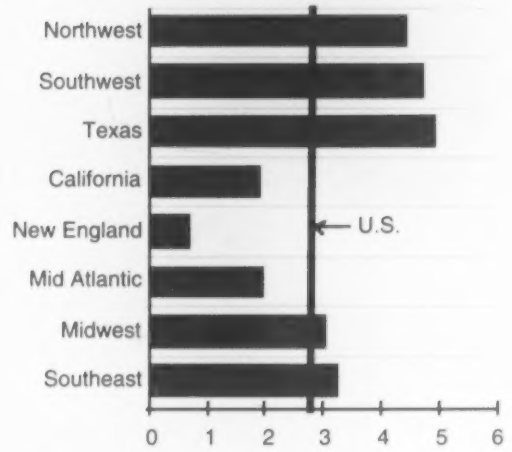
First Interstate Territory

Recession/Recovery

The East Coast, California, and some of the Midwest industrial states, such as Michigan, bore the brunt of the recession, which began in mid 1990. Meanwhile, the Pacific Northwest and the Southwest continued to expand, although at a more moderate pace. The "oil patch" recovered further, with gains in Texas and Louisiana,

By the third quarter of 1991, the Northwest, Southwest, and Texas/Louisiana all showed year-to-year gains in personal income above both the national average and the rate of inflation. In contrast, California, New England, and the Mid-Atlantic states trailed the U.S. average and the general inflation rate. Income growth in the Midwest and Southeast had recovered but had still not kept pace with the overall rise in prices.

Disparity In Regional Income Growth
(Percent change, 90Q3 to 91Q3)



"Going West"

The West has continued the trend of the 1980s, with the fastest growth in the country since the 1990 census. Growth in the West has persisted at about twice the national population rise of 1% per year. The ten fastest growing states recently were Nevada, Alaska, Idaho, Washington, Oregon, Utah, Florida, Colorado, Hawaii, and Arizona.

Population and economic growth are closely intertwined. New residents boost retail sales and home construction, and job prospects attract new residents. The United States is a more mobile country than many other industrial nations, which is an asset as industries rise and fall in various regions. Individuals have moved to take advantage of changing job opportunities, adding to the economy's dynamism.

Population growth has recently picked up significantly in the Midwest compared with the 1980s, with every state in the region showing a faster increase except North Dakota. In contrast, whereas New England was one of the most rapidly growing regions in the 1980s, the 1990s have begun with an actual loss of population in New Hampshire and Massachusetts.

As economic recovery spreads through the nation during the next two years, the "push-pull" phenomenon of "poor-strong" economies will diminish somewhat. We expect the West to remain the most rapidly growing region in the country, as people are attracted to both the area's living conditions and its job opportunities. California is likely to continue to gain sizable numbers of new residents, although some of them may then "bounce" to adjacent states for jobs or housing.

POPULATION IN FI TERRITORY

	July 1, 1991 Estimate Thousands	July 1, 1993 Forecast Thousands	Avg. Annual Growth 93/91 % Change
Alaska	570	582	1.0
Arizona	3,768	3,920	2.0
California	30,665	32,053	2.2
Colorado	3,331	3,415	1.3
Idaho	1,039	1,070	1.5
Iowa	2,795	2,823	0.5
Louisiana	4,252	4,303	0.6
Montana	808	824	1.0
Nevada	1,214	1,291	3.1
New Mexico	1,574	1,617	1.4
North Dakota	635	630	-0.4
Oregon	2,922	3,041	2.0
South Dakota	703	716	0.9
Texas	17,349	17,944	1.7
Utah	1,752	1,805	1.5
Washington	5,004	5,216	2.1
Wyoming	460	470	1.1
FI Territory	78,841	81,720	1.8
U.S.	252,120	257,468	1.1

Performance in First Interstate Territory

First Interstate has affiliate banks or franchise relationships in 17 states. With the exception of California, all of the states outperformed the nation in 1991 in terms of employment growth. Most of the Territory's states will match or exceed the national performance again in 1992-93.

The Pacific Northwest (Alaska, Idaho, Montana, Oregon, and Washington) will remain one of the strongest parts of the country during the next two years. The wood products industry, which has been the region's weakest sector, should improve modestly with an upturn in housing. The impact of

environmental concerns on timber supplies will prevent a stronger rebound. Various manufacturing segments, including high-tech enterprises, should benefit from a general upswing in the national economy. International trade will be an additional positive force. Aircraft employment in the Seattle area, however, is likely to remain flat, and military bases in Washington, Idaho, and Montana could be vulnerable to a new round of defense cuts in future years.

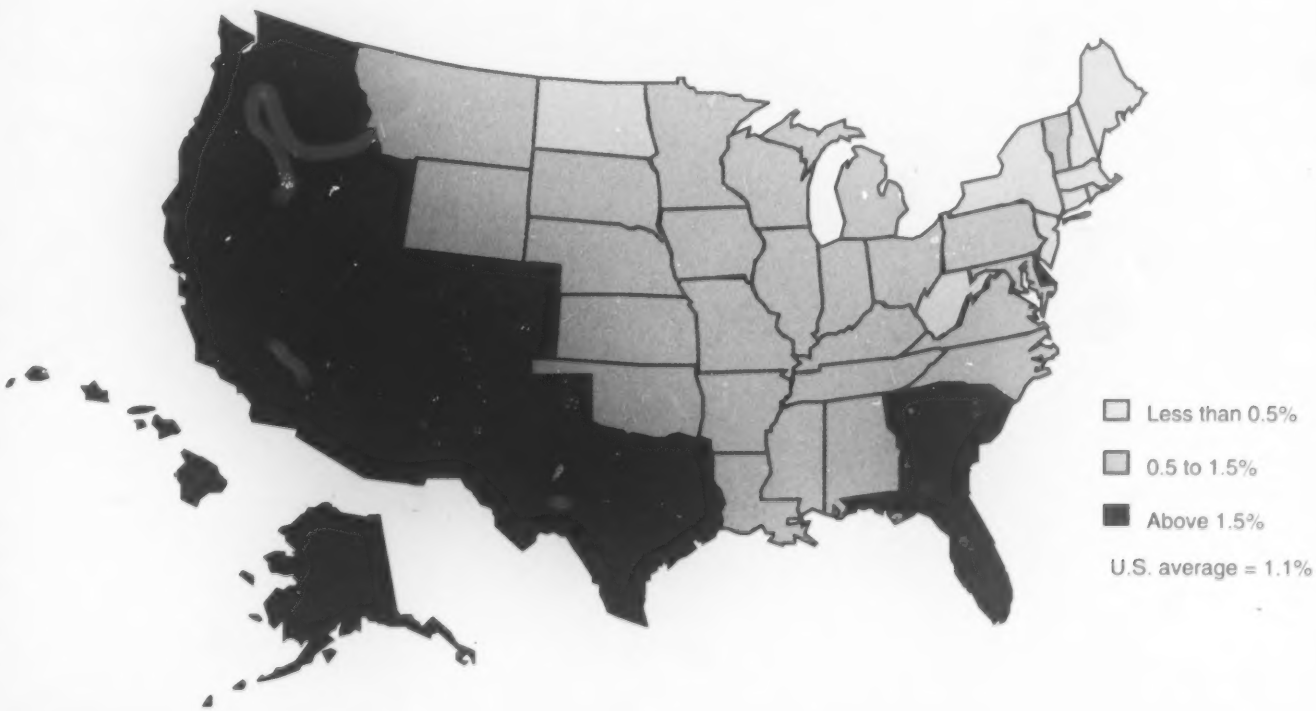
California has suffered the twin depressants of a steep downturn in construction and defense cuts, as well as longer-term issues involving its business climate. We believe, however, that the state will recover along with the nation in 1992 and 1993. (For additional information, see the California Edition of the *Forecast Update*.)

The Southwest (Arizona, Colorado, Nevada, New Mexico, Utah, and Wyoming) finds Arizona only slowly absorbing its excess of nonresidential space, but showing sizable overall employment gains. The housing sector continues to improve, with higher home prices and lower vacancy rates for apartments. Nevada's growth has dropped significantly from the explosive rates of recent years, but it remains above that in most states. Brighter prospects for tourism should be positive for the region in 1992-93. Construction employment will increase again during the next two years as the development of major new hotels and resorts proceeds. Colorado and Utah are registering impressive gains as they attract various high-tech and other manufacturing industries. New Mexico will also receive some growth impetus from the "spillover" of California residents and businesses to surrounding states.

Texas has recovered substantially from the oil price "boom-bust" phase of the 1980s. Employment, personal income, and home prices have all recovered significantly in the past two years. Progress is also being gradually achieved in working off the surplus of office space. Louisiana has a less diversified economy than Texas, but we expect both states to show gains in 1992-93.

The Northern Plains states of North and South Dakota, together with Iowa, have experienced some of the effects of the national recession in terms of reduced orders and shipments for various manufactured goods. While North Dakota will be affected by defense cuts, the region should benefit from a general revival in U.S. manufacturing. South Dakota's economy continues to be bolstered by growth in various services, including health care and finance. The farm sector will be helped by its generally stronger financial position and a competitively valued dollar, although world supply/demand conditions for various crops will remain volatile.

Population Shifts West
(Average annual percent change, April 1, 1990 to July 1, 1991)



NONFARM PAYROLL EMPLOYMENT

	1990		1991e		1992f		1993f	
	Thousands	% Change	Thousands	% Change	Thousands	% Change	Thousands	% Change
Alaska	**237**	**4.4**	**241**	**1.6**	**242**	**0.5**	**245**	**1.0**
Arizona	1,491	2.5	1,517	1.8	1,558	2.7	1,613	3.5
California	**12,865**	**2.3**	**12,405**	**-3.6**	**12,472**	**0.5**	**12,797**	**2.6**
Colorado	1,518	2.4	1,549	2.0	1,588	2.5	1,637	3.1
Idaho	**385**	**5.3**	**398**	**3.2**	**412**	**3.5**	**424**	**3.0**
Iowa	1,224	2.0	1,234	0.8	1,244	0.8	1,274	2.4
Louisiana	**1,594**	**3.6**	**1,624**	**1.9**	**1,655**	**1.9**	**1,690**	**2.1**
Montana	297	2.2	301	1.3	307	2.0	313	2.0
Nevada	**624**	**7.4**	**639**	**2.4**	**661**	**3.4**	**688**	**4.1**
New Mexico	575	2.3	581	1.0	589	1.4	602	2.2
North Dakota	**266**	**2.0**	**270**	**1.7**	**275**	**1.7**	**280**	**2.0**
Oregon	1,248	3.2	1,265	1.4	1,297	2.5	1,336	3.0
South Dakota	**289**	**4.5**	**297**	**3.0**	**304**	**2.4**	**313**	**2.8**
Texas	7,033	2.8	7,124	1.3	7,238	1.6	7,426	2.6
Utah	**723**	**4.6**	**748**	**3.4**	**776**	**3.7**	**807**	**4.0**
Washington	2,155	5.0	2,183	1.3	2,201	0.8	2,278	3.5
Wyoming	**199**	**3.1**	**202**	**1.6**	**204**	**1.0**	**207**	**1.5**
FI Territory	32,723	2.9	32,578	-0.4	33,022	1.4	33,929	2.7
U.S.	**109,971**	**1.5**	**108,967**	**-0.9**	**109,715**	**0.7**	**112,321**	**2.4**

PERSONAL INCOME

	1990		1991e		1992f		1993f	
	$ Billions	% Change	$ Billions	% Change	$ Billions	% Change	$ Billions	% Change
Alaska	**12.0**	**6.0**	**12.4**	**4.0**	**12.8**	**3.2**	**13.4**	**4.0**
Arizona	58.9	5.9	61.9	5.0	65.7	6.1	70.3	7.0
California	**619.4**	**7.4**	**628.1**	**1.4**	**656.9**	**4.6**	**702.3**	**6.9**
Colorado	62.4	7.0	65.6	5.2	70.0	6.7	75.0	7.1
Idaho	**15.4**	**9.0**	**16.0**	**4.0**	**16.7**	**4.2**	**17.4**	**4.0**
Iowa	47.9	6.7	49.3	2.9	51.4	4.4	54.6	6.2
Louisiana	**61.2**	**7.8**	**64.6**	**5.5**	**68.2**	**5.5**	**72.2**	**5.9**
Montana	12.2	5.7	12.7	3.9	13.2	4.4	13.9	4.7
Nevada	**23.3**	**11.4**	**24.6**	**5.6**	**26.3**	**6.9**	**28.4**	**8.0**
New Mexico	21.7	7.1	22.8	5.2	24.1	5.7	25.7	6.6
North Dakota	**9.7**	**7.1**	**10.0**	**2.9**	**10.4**	**4.8**	**11.1**	**6.0**
Oregon	49.2	8.3	51.5	4.6	54.2	5.3	57.3	5.7
South Dakota	**11.0**	**9.7**	**11.4**	**3.6**	**12.1**	**5.9**	**12.9**	**6.9**
Texas	285.1	8.2	300.5	5.4	317.6	5.7	338.6	6.6
Utah	**24.2**	**8.6**	**25.8**	**6.6**	**27.6**	**7.0**	**29.7**	**7.6**
Washington	92.2	9.2	96.6	4.8	101.1	4.6	108.1	6.9
Wyoming	**7.4**	**7.8**	**7.7**	**4.4**	**8.1**	**5.2**	**8.6**	**6.2**
FI Territory	1,413.1	7.7	1,461.4	3.4	1,536.5	5.1	1,639.2	6.7
U.S.	**4,662.7**	**6.5**	**4,812.7**	**3.2**	**5,036.3**	**4.6**	**5,367.8**	**6.6**

Note: Calculations based on unrounded data.
Data based on sources currently available, subject to sizable revisions.

First
Interstate
Bancorp

FORECAST 1992-1993

UPDATE

June 1992
Including Five-Year Projections
First Interstate Territory Edition

First Interstate Bancorp

Contents

Overview	1
The U.S. Economy	2
Industry Perspective	6
Financial Institutions/Credit	9
The International Economy	11
First Interstate Territory	14

BANKING AFFILIATES

California
First Interstate Bank of California
First Interstate Bank, Limited
First Interstate Bancard Co., N.A.

Northwest
Alaska
First Interstate Bank of Alaska, N.A.
Idaho
First Interstate Bank of Idaho, N.A.
Montana
First Interstate Bank of Montana, N.A.
Oregon
First Interstate Bank of Oregon, N.A.
Washington
First Interstate Bank of Washington, N.A.

Southwest
Arizona
First Interstate Bank of Arizona, N.A.
Colorado
First Interstate Banks of Denver, N.A., and Englewood, N.A.
Nevada
First Interstate Bank of Nevada, N.A.
New Mexico
First Interstate Bank of New Mexico, N.A.
Utah
First Interstate Bank of Utah, N.A.
Wyoming
First Interstate Bank of Wyoming, N.A.

Texas
First Interstate Bank of Jacksonville
First Interstate Bank of Texas, N.A.

BANK LICENSEES

Colorado
First Interstate Banks of Arvada, N.A., Centennial, N.A., Golden, N.A., and Westminster, N.A.
First Interstate Bank of South Fort Collins
First Interstate Bank of Fort Collins, N.A.

Louisiana
First Interstate Bank of Southern Louisiana

Montana
First Interstate Banks of Billings, N.A., Billings Heights, Colstrip, Hardin, Miles City, Missoula, N.A., and West Billings

North Dakota
First Interstate Bank of Fargo, N.A.

South Dakota
First Interstate Bank of South Dakota, N.A.

Wyoming
First Interstate Bank of Commerce

FOREIGN LOCATIONS

Abu Dhabi	Nassau
Bangkok	Rio de Janeiro
Beijing	Seoul
Hong Kong	Shanghai
Jakarta	Singapore
Lima	Sydney
London	Taipei
Madrid	Tokyo
Manila	Toronto
Mexico City	Vancouver

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OVERVIEW

Despite periodic setbacks, the evidence suggests that a recovery of the U.S. economy is under way. The upturn also appears to be becoming more widespread. This *Update* reviews the prospects for the next eighteen months and also assesses the economic climate likely to prevail in the five years through 1997.

Near Term

Recovery Takes Hold

The sharp drop in short-term interest rates, the easing in monetary policy in terms of rapid bank reserve growth, and the improved state of balance sheets in the private sector have continued to pave the way for economic recovery. Economic growth in the second half of 1992 and throughout 1993 will still equal only about half the gains commonly seen in the early stages of an upturn, but a gradual improvement in job markets and a surge in corporate profits will be tangible evidence of the beginning of a new expansion.

The road ahead is certainly not clear of visible, or perhaps hidden, obstacles. Adjustments to defense declines and an overhang of office, hotel, industrial, and retail space will impede growth in certain regions. Long-term interest rates have shown little decline, and a further run-up in mortgage rates could thwart recovery in the housing industry. Internationally, a more severe slowing in Germany or Japan than we anticipate could damage an export sector that is becoming increasingly important to the U.S. economy.

Despite these risks, the recovery is unlikely to be easily derailed during the next 1-1/2 years. The banking industry is now much better capitalized than a year ago and will be seeking lending opportunities. Internationally, dramatic improvement in Mexico's economy and continued growth in the newly industrialized economies of the Far East will provide ongoing export opportunities for U.S. firms.

Medium Term

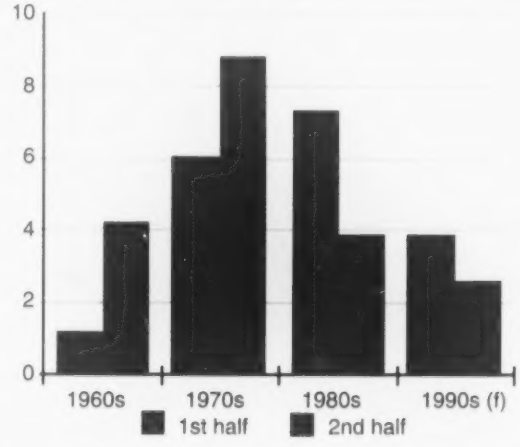
The Goal of Lower Inflation

The Federal Reserve has made clear its intention to try to attain zero inflation or price stability over the next few years. Lower inflation would not hurt prospects for growth, but rather raise those prospects. The Federal Reserve's task will be made more difficult, however, by lack of success in effectively curbing the growth of government spending. Ultimately, the rise in various entitlement programs will have to be checked. As the summer of 1992 begins, uncertainty about our political leadership and the direction of the nation over the next five years is at one of the highest levels in history.

Including this year's performance, our forecast is for growth to average 2.6% per year over the period ending in 1997. This rate is probably close to the economy's current potential. Inflation is likely to average about 3.2% per year. A significant slowing in economic activity is a likely possibility sometime during 1995-96 in response to a slowing in monetary growth, but recessions are by no means inevitable in the U.S. economy.

Inflation Moderates in the 1990s

(Average annual change in consumer price index)



We expect many of the restrictions on interstate banking and branching to be removed over the next five years, which will make U.S. financial institutions stronger and more competitive. Internationally, trade should benefit from the gradual integration of Eastern Europe, Russia, and the Central Asian republics into the world market system, as well as a re-emergence of Latin America as a primary growth region. Despite uncertainty about the results of elections in Europe and the United States, economic integration is likely to advance in Europe, Latin America, and Asia over the next five years, resulting in greater economies of scale, as well as expanded trade, investment, and economic growth.

First Interstate Territory

With the exception of California, the states in the First Interstate Territory have weathered the recession relatively well. The Northwest, Southwest, and Texas all outperformed the nation in terms of personal income growth in 1991, a trend expected to carry through 1992-93. California's economy will improve over the five years through 1997, while the continued population shift south and westward will support better-than-average growth in most of the First Interstate Territory.

The U.S. Economy

Near Term

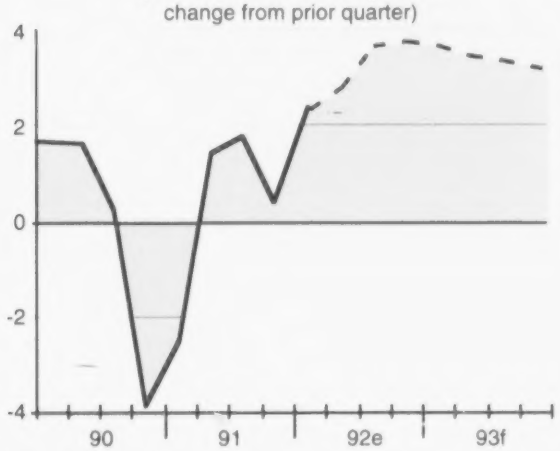
The U.S. economy has now recorded increases in real GDP for four consecutive quarters. The weakness of the recovery and the economy's "stall" at the end of last year made many people question whether an upturn was under way at all. Indeed, output is just now returning to the level reached before the recession struck in the second half of 1990.

Monetary Policy—Setting the Stage

Although the signals are not consistent, Federal Reserve policy has been generally expansive thus far in 1992. Bank reserves soared at an annual rate of about 20% from the fourth quarter of 1991 through May. The monetary base, consisting of reserves and currency (adjusted for foreign holdings), increased at a sizable pace of 8.3%. Meanwhile, the federal funds rate has been cut to 3.75%, only slightly above the rate of inflation (3.3% at the consumer level from the fourth quarter). However, the growth of M2 (currency, checking, savings, and small CDs) has been only 2.3% so far this year. We expect growth to pick up later in 1992, as firming interest rates check the runoff in bank CDs.

The Federal Reserve will attempt to maintain its gains against inflation and will allow the federal funds rate to move upward as the market tries to push up interest rates. Holding the fed funds rate down would cause bank reserves and the monetary aggregates to soar. We still expect M2 growth to be sizable in 1993, with a gain of 5.1%, following gains of 4.4% in 1992 and only 2.8% in 1991.

Recovery is Sustained
(Real GDP, annualized percent change from prior quarter)



Fiscal Policy—Gridlock

Despite a flurry of activity accompanying this year's State of the Union message, the President and Congress quickly dispatched bills to stimulate the economy to the paper shredder. Efforts to "jumpstart" the economy may actually have done some harm, as long-term interest rates shot up early in the year because of concern over the budget deficit. As the election approaches, Congress is deferring further defense cuts in some regions and has backed additional spending for the inner cities.

After the election, the President and Congress may again turn to the deficit issue. The renewed popularity of a balanced budget amendment and the prospect of new faces in Washington may induce a shift to fiscal restraint in 1993. Also, the "peace dividend" provides a rare opportunity to restrain the rise in government outlays.

Economic Recovery—Moving on Track

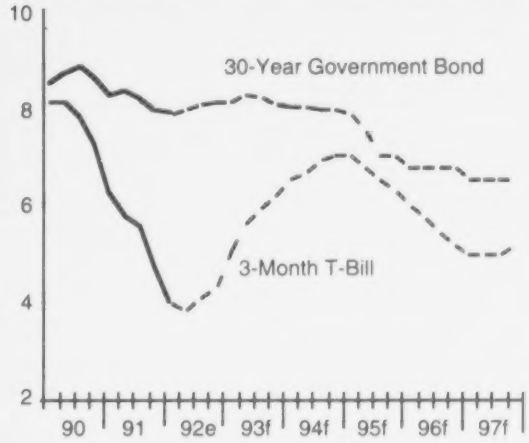
The economy will not move in a straight line, but, despite occasional brief setbacks in some areas, the overall trend will be upward during the next eighteen months. Consumer spending will grow moderately, housing will continue to recover, and spending on infrastructure—including roads, rapid transit, and airports—will be strong. Exports will continue to grow, although more moderately than in 1991, while defense and commercial construction will decline. As companies throughout the economy begin to rebuild inventories, demand will receive an additional stimulus. Real GDP is likely to expand at a rate exceeding 3.5% in the second half of 1992, with growth in 1993 slightly less than 3.5%. Such growth will still be about half the "normal" pace usually seen in the early stages of recovery.

After-tax operating profits will surge at double-digit rates both this year and in 1993. Companies have been cautious for the past year in hiring new workers because signs of recovery have been so sporadic. While layoffs will continue in some industries, including defense and banking, most industries will add at least marginally to payrolls by the end of this year. As job prospects improve, more people will re-enter the workforce, limiting the decline in the jobless rate. This rate should still recede from its 7.5% peak in May to less than 7% by the end of 1992 and about 6% by yearend 1993.

Inflation—Good News

Consumer prices are likely to rise only 3.4% this year and 3.5% in 1993, as the monetary policy of the past three years continues to yield dividends. An inflation rate of about 3.5% contrasts with the average 7.1% inflation recorded during the 1970s and 5.5% in the 1980s. Oil prices are likely to remain moderate over the next two years, with the price of West Texas Intermediate at $21.00-$22.00 a barrel over the period. While demand for oil will be rising over the next eighteen months, additional supplies will be forthcoming from Kuwait as well as other producing countries. Recent indications, however, that Saudi Arabia may constrain output could keep prices higher over the next several months.

Short Rates Show Cyclical Rise
(Percent, quarterly average, bond-equivalent yields)



Interest Rates—Changes Ahead

The gap between short- and long-term interest rates has recently reached record levels, with the 30-year Treasury bond yield more than four full percentage points above the yield on 3-month Treasury bills. This disparity reflects the market's belief that short-term interest rates will rise, a trend characteristic of economic recoveries.

We expect short-term interest rates to rise only about 50-75 basis points between 1992's second quarter and yearend, but then increase 150-175 basis points in 1993. Such an increase would place 3-month Treasury bill rates at 4.25% at the end of 1992 and 6.0% by year-end 1993. An increase of this magnitude would still leave short-term rates below their levels of late 1990, when 3-month Treasury rates were about 7.0%.

Long-term interest rates, in contrast, will rise modestly with signs of economic growth, as inflation remains subdued and rates are already quite high. Our forecast is that the long-bond yield will equal 8.1% at the end of 1992 and peak at about 8.3% in mid 1993. If actions by the Federal Reserve to rein in monetary growth can lower inflationary expectations, 30-year government bond yields could drift back to 8.0% by the end of 1993.

Medium Term

Monetary and fiscal policy, demographics, and adjustments in the defense and commercial real estate sectors will be key elements of the economic landscape over the next five years. The decade of the 1990s will continue to be different from the 1980s.

Monetary Policy—Meeting the Challenge

The current Federal Reserve seems committed to reduce inflation over the next five years. A decrease in inflation will not harm prospects for growth. To the contrary, lower inflation will raise potential growth by reducing the resources devoted to finding inflation hedges, by shrinking the inflation-risk premium in interest rates, and by allowing the price system to function more efficiently.

Although U.S. monetary authorities have indicated a goal of zero inflation or stable prices, constraining the annual rate of increase in consumer prices to the 1-2% range would be considered success by many. This is because of the difficulty in measuring inflation precisely. Some of the increase in reported consumer prices, for example, may reflect improvements in product quality or service.

The only effective approach to reducing inflation will be to hold a tight rein on monetary growth during the next five years. We believe that M2 growth generally will be constrained to the 4-5% range during the next five years, which will allow inflation to remain close to 3% during most of the period, easing to around 2.5% by 1997.

Fiscal Policy—Roadblock to Progress?

Fiscal policy will circumscribe the Federal Reserve's ability to subdue inflation. A faster growth of government spending and debt confronts the monetary authorities with a difficult choice: monetize the debt or allow real interest rates to rise. The present Federal Reserve appears determined to resist the first alternative and, therefore, could be expected to permit some "crowding out" of private borrowers as interest rates rise. Fiscal policy will, thus, be a critical issue over the next five years.

The issue of fiscal policy should be framed in terms of spending as opposed to the deficit. "Crowding out" occurs when government sector spending displaces spending by the private sector.

Results of state and local elections point to an electorate still pledged to a lower tax/spending policy. The "anti-incumbency" mood of the country is also likely to lead to more fiscal conservatism. Consequently, federal spending as a share of GDP could ease from around 25% in 1992 to 21-22% by 1997. This reduction could help reduce the deficit from its recession peak of 6% of GDP in 1992 to less than 3% by 1997.

ECONOMIC PROJECTIONS

	Fourth Quarter		Annual Average	
	Real GNP*	Consumer Prices*	3-Month T-bill Rate	30-year Govt. Bonds
	(Percent)		(Percent)	
1991 actual	**0.3**	**3.0**	**5.37**	**8.14**
1992	3.2	3.4	3.95	7.96
1993	**3.4**	**3.5**	**5.53**	**8.15**
1994	2.9	3.5	6.57	7.93
1995	**1.6**	**3.2**	**6.43**	**7.33**
1996	1.3	3.0	5.43	6.75
1997	**3.3**	**2.5**	**4.86**	**6.50**

*Change over prior year

FORECAST OF INTEREST RATES

(Quarterly averages)

	1991				1992				1993			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Short-Term	Actual					Forecast						
Fed Funds (Overnight)	6.43	5.86	5.64	4.82	4.02	3.77	4.04	4.38	5.17	5.67	5.92	6.17
Treasury Bills (3-month)[1]	6.02	5.56	5.38	4.54	3.89	3.71	3.98	4.21	4.97	5.47	5.72	5.97
CDs (3-month, secondary)	6.71	6.02	5.70	4.91	4.13	3.92	4.29	4.54	5.27	5.77	6.02	6.27
Eurodollar (3-month)	6.76	6.04	5.72	4.93	4.12	3.96	4.31	4.56	5.29	5.79	6.04	6.29
Prime Rate	9.19	8.67	8.40	7.60	6.50	6.50	6.50	6.80	7.33	7.96	8.29	8.50
Long-Term												
U.S. Government Bonds (30-yr)[2]	8.20	8.32	8.18	7.85	7.80	7.93	8.02	8.10	8.13	8.25	8.20	8.00
Corporate Aaa (Moody's)	8.93	8.91	8.79	8.45	8.28	8.29	8.35	8.45	8.55	8.69	8.66	8.53
Mortgage Rate (Fixed)[3]	9.50	9.53	9.28	8.69	8.71	8.76	8.85	8.95	9.05	9.19	9.16	9.03

(1) Bank discount basis. (2) Yields adjusted to constant maturities. (3) Contract rates on first mortgages, conventional market.

Demographics—How Much More Saving?

As the "baby boom" population grows older, the population segment of 45-64 year-olds will have expanded 12% in the five years ending in 1995 and another 17% by the year 2000. Long-run demographic trends, which have been obscured somewhat by the recent recession, will become clearer in the next five years. The aging "baby boom" group is likely to help raise the overall saving rate. The composition of spending is also likely to shift toward a lesser share for housing and larger shares for education, parental care, travel, and other services.

Defense & Commercial Real Estate—Down

Defense outlays will drop in real terms at a rate close to 4% a year over the next five years. This will cause military outlays to fall to 3.5-4.0% of GDP by 1997 from the peak of 6.5% in 1986. While this decline will continue to cause difficulties for various regions, it will not negatively impact the economy's overall growth rate. Resources will be freed and diverted to other applications.

For many regions of the country, absorption of the large additions to office, retail, and hotel space added during the 1980s will take most of the five years through 1997. Prices and rental rates in 1992 have probably reached their lows. While some industrial building will take place, new commercial construction will remain constrained during the period. In contrast, public infrastructure spending on roads, rapid transit, water systems, and airports will continue to show strength.

Economic Trends through 1997

The economy is unlikely to record a path of steady economic growth over the next five years, but a lower trend of inflation should produce less volatility than recorded during the 1980s. We expect real GDP growth to average 2.6% per year over the 1992-97 period. This is probably close to the economy's potential rise in view of environmental and other uses of resources, which may not be completely reflected in output measures. Efforts by the Federal Reserve to slow monetary growth after 1993 are likely to trigger a slowing in economic expansion sometime during 1995-96. While an actual contraction in economic activity might be avoided, a "growth recession" is not unlikely.

Inflation will average about 3.2% a year over the 1992-97 period in terms of consumer prices. Treasury bill rates are projected to average 5.5% over the period, while the 30-year bond yield averages 7.4%. Short-term interest rates are likely to rise to a peak in late 1994, with the 3-month Treasury bill rate reaching 7.0%. If the bond market is convinced that the Federal Reserve is intent on quashing inflation, then long-term yields could peak at the 8.3% yield of mid 1993.

The gap between short-term and long-term interest rates is expected to average slightly less than 1.5 percentage points over the 1993-97 period, in contrast to the record 4 percentage points of 1992. Real interest rates could still be relatively high at the end of the five-year period for several reasons: (a) worldwide demands for capital, in Eastern Europe and elsewhere, will still be strong relative to supply; (b) the U.S. budget deficit will still be sizable, even at reduced levels, relative to the economy; (c) investors will need more time before they believe that the 2.5% inflation rate expected for 1997 is sustainable.

The difference between the 30-year bond yield and inflation could still be about four percentage points in 1997. Continued success of the Federal Reserve in curbing inflation, however, could reduce the "real" interest rate to about 3%, a development which would help growth prospects for the final five years of the century.

MAJOR ECONOMIC INDICATORS

	QUARTERLY												4TH QUARTER					
	1991				1992				1993				% Change			% Change		% Change
	I	II	III	IV	I	II	III	IV	I	II	III	IV	1991	'91/'90	1992	'92/'91	1993	'93/'92
	Actual				Forecast				Forecast				Actual		Forecast			
GROSS DOMESTIC PRODUCT (Billions of $, annual rate)	5589	5653	5709	5740	5818	5900	5998	6099	6198	6298	6398	6498	5740	3.3	6099	6.3	6498	6.5
% Change, annual rate	2.3	4.6	4.1	2.2	5.5	5.8	6.8	6.9	6.7	6.6	6.5	6.4						
REAL GDP (Billions of 1987 $, a.r.)	4824	4841	4863	4868	4897	4932	4977	5024	5069	5113	5156	5197	4868	0.3	5024	3.2	5197	3.4
% Change, annual rate	-2.5	1.4	1.8	0.4	2.4	2.9	3.7	3.8	3.7	3.5	3.4	3.2						
REAL FINAL DOMESTIC SALES* (Billions of 1987 $, a.r.)	4872	4881	4894	4884	4938	4957	4992	5032	5073	5114	5152	5191	4884	-0.7	5032	3.0	5191	3.2
% Change, annual rate	-3.7	0.7	1.0	-0.8	4.5	1.6	2.9	3.3	3.3	3.3	3.0	3.0						
REAL CHANGE IN INVENTORIES (Billions of 1987 $, a.r.)	-33	-30	0	8	-18	1	11	17	21	22	25	26	8	N/A	17	N/A	26	N/A
GDP DEFLATOR (1987=100)	115.9	116.8	117.4	117.9	118.8	119.6	120.5	121.4	122.3	123.2	124.1	125.0	117.9	3.0	121.4	3.0	125.0	3.0
% Change, annual rate	5.0	3.1	2.1	1.7	3.1	2.8	3.0	3.0	2.9	3.0	3.0	3.1						
CONSUMER PRICE INDEX (1982-84=100)	134.9	135.7	136.6	137.8	138.8	140.1	141.3	142.5	143.7	144.9	146.2	147.5	137.8	3.0	142.5	3.4	147.5	3.5
% Change, annual rate	3.3	2.4	2.7	3.6	2.9	3.8	3.4	3.5	3.4	3.5	3.5	3.6						
AUTO SALES (Millions, annual rate)	8.3	8.4	8.6	8.2	8.3	8.4	8.8	9.0	9.2	9.5	9.7	9.7	8.4**	-11.7	8.6**	2.7	9.5**	10.5
HOUSING STARTS (Millions, annual rate)	0.92	1.00	1.04	1.10	1.26	1.22	1.30	1.33	1.35	1.36	1.36	1.37	1.01**	-15.0	1.28**	26.0	1.36**	6.4
INDUSTRIAL PRODUCTION (1987=100)	105.8	106.4	108.1	107.9	107.2	108.8	110.2	111.7	113.0	114.3	115.6	116.8	107.9	-0.6	111.7	3.5	116.8	4.6
% Change, annual rate	-9.6	2.3	6.5	-0.7	-2.6	6.1	5.3	5.4	4.8	4.7	4.5	4.4						
NONFARM EMPLOYMENT (Millions)	108.6	108.2	108.3	108.2	108.1	108.5	109.1	109.7	110.5	111.2	111.9	112.6	108.2	-1.0	109.7	1.4	112.6	2.6
UNEMPLOYMENT RATE, CIVILIAN (Percent)	6.5	6.7	6.8	6.9	7.2	7.3	7.0	6.8	6.6	6.4	6.2	6.0	6.9	N/A	6.8	N/A	6.0	N/A
ECONOMIC PROFITS AFTER TAXES (Billions of $, annual rate)	183	180	178	189	212	206	210	216	227	232	238	248	182.3**	-0.7	211**	15.7	236.2**	12.0
% Change over year ago	-9.9	-10.8	10.2	11.9	16.1	14.3	8.2	14.3	7.0	12.5	13.6	14.7						
MONEY SUPPLY M2 (Billions of $, a.r.)	3367	3404	3410	3429	3465	3474	3524	3574	3623	3669	3714	3758	3429	2.8	3574	4.2	3758	5.1
% Change, annual rate	3.8	4.5	0.6	2.3	4.3	1.0	5.9	5.8	5.6	5.2	5.0	4.8						

NOTE: All quarterly series are seasonally adjusted; % change, annual rate calculated from prior quarter; calculations based on unrounded data; a.r. = annual rate. *Excluding Commodity Credit Corp. purchases

**Annual total. N/A = Not applicable

Industry Perspective

Near Term

Mixed Outlook

In the next two years many industries will realize significant improvement, although others will undergo further restructuring. Retail trade and durable-goods manufacturing industries, such as furniture and automobiles, will see a cyclical recovery. However, consumer spending growth will be more moderate than usual, as individuals work down debt levels and as demographic shifts lead to a bulge in age groups more likely to save than spend. Commercial construction is also likely to perform poorly over the near term. High office-vacancy rates in many metropolitan areas and a lack of demand for new commercial space will likely lead to a significant consolidation among the players in this industry. Difficulty in raising capital for new projects will also be a constraining factor.

Health-care services, pharmaceuticals, and health-care equipment manufacturing should continue to perform above average in the near term. However, continuing pressure from government and industry to reduce the growth of health care expenditures may place some downward pressure on pricing in these industries. Also, stricter regulatory and lengthier product-approval procedures may limit the strong growth witnessed in the pharmaceuticals and medical equipment industries in the last several years. As demographic shifts and productivity increases result in an aging population and a modest increase in average real incomes over the next few years, demand for health care services (which is positively correlated with income) should continue to grow.

Limits on Government Spending Will Encourage Privatization

As the current conditions of many state (and the federal) budgets indicate, funding for public projects and programs is likely to be strained in the next few years. Admittedly, some funds already raised have been specifically earmarked for the repair and building of infrastructure and should provide significant demand for industries such as public construction. For example, the federal transportation bill has authorized the expenditure of $124 billion on highway and safety programs and an additional $32 billion on mass-transit projects over the next six years.

However, government budget shortfalls may lead to higher taxes for businesses in many states and are likely to result in at least some "crowding out" of private investment over the near term. Shortfalls in government revenues are likely to lead to a greater level of "privatization" of such publicly-owned and operated facilities as prisons, schools, and water and waste utilities.

The Bush Administration recently set the groundwork to facilitate the transfer of publicly owned assets to the private sector by signing an executive order that eases the required repayment of federal development funds when a public facility is sold. Some current estimates place the total market value of such publicly-run facilities as airports and waste and water treatment plants at $60 billion. By privatizing these and other assets, state and local governments would reduce or eliminate outlays associated with their operation, while increasing tax revenues. Many of these operations would also be run more efficiently in an environment of greater competition.

Impact of Regulation

Environmental and other regulatory issues will continue to affect many industries heavily through the end of this decade. Recent attempts by the Bush Administration to reverse regulatory burdens on U.S. industry are likely to help to some extent. Also, the government's desire to encourage stronger economic growth in the near term should cause it to defer more to industry in the debate over the proper amount of government involvement and oversight.

The high costs of environmental litigation, regulation, and acts of "eco-terrorism" (such as the Alar scare) will consume greater amounts of capital in such industries as oil and gas, chemicals, forestry and agriculture, mining, paper and pulp, automobiles, electronics, and steel. Some industries, such as food processing, medical equipment, and pharmaceuticals, are likely to face a greater regulatory burden in the next several years as stricter controls aimed at protecting or better informing consumers are put in place.

In general, however, the cost of regulations and their negative impact on growth are likely to cause some easing in the amount of regulatory activity over the next several years. The 1993 federal budget estimated the gross cost of federal regulation at slightly over half a trillion dollars in 1990 (or more than one and one-half times total outlays on national defense in that year).

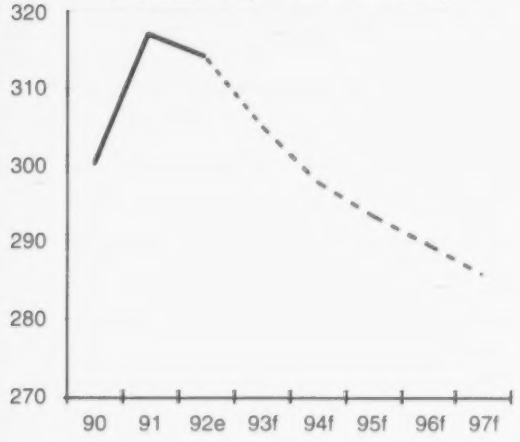
Medium Term

Defense Industry in Transition

Significant cuts in defense spending will continue to force a consolidation in aerospace and defense-related industries. Some attempt may be made to re-employ these industries' factors of production in commercial manufacturing, but, given past experience, this transition will be difficult (except in high-tech electronics and avionics). As the following

graph indicates, defense outlays will continue to shrink over the medium term, although the current rate of decline in defense spending could ease by the mid 1990s, as various programs presently in the development phase enter limited production. Sufficient demand should remain to allow a select few defense firms to continue to prosper by focusing their efforts on key areas and by dominating output in those segments. Future efforts are likely to center around high-tech R&D in surveillance, tracking, and communications applications.

Lower Spending to Force Defense Industry Consolidation
(Defense outlays, billions of dollars)



Litigious Environment May Burden U.S. Industry

There has been an unprecedented increase in the number of legal constraints and lawyers in the United States during the last twenty years. In the 1970s, the number of practicing attorneys doubled, while increasing another 50% during the 1980s. Almost 70% of the world's lawyers are located in the United States. The legal services industry has become highly competitive, with the rise in supply of lawyers and a decline in the overall frequency of civil litigation. Certain fields have seen rapidly increasing demand, however. Recession-related bankruptcies, problems in the S&L industry, and the explosion in environmental litigation have provided much new business for the legal profession in recent years.

For many industries increased litigation related to product liability, environmental issues, and copyright/patent infringement has caused an inefficient allocation of resources away from investments in R&D and productivity-enhancing improvements. For example, the threat of broadly-targeted litigation in such high-tech industries as computers and software has likely led to a slower rate of innovation, as firms must "re-invent the wheel" in an attempt to avoid costly legal challenges. The proliferation of legal actions based on tenuous assumptions of infringement increases the costs of innovation, reducing the incentives that patent/copyright protection are designed to foster.

Environmental litigation has been the bane of several industries of late, most notably forestry. Efforts to control the volume of timber harvested in the Pacific Northwest have involved vast amounts of legal maneuvering (and expense) by the forest products industry, environmentalist groups, and state and federal governments. Lawsuits based on hazardous waste liability have also mushroomed in recent years. The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or "Superfund") has perhaps done more to support environmentally related litigation activity than any other federal or state law. A recent study by the Rand Institute for Civil Justice provides an example of the wasteful allocation of resources involved in Superfund cases. The study points to the fact that 80-96% of the costs involved in such cases go toward "transactions costs" (mostly legal expenses incurred by insurance companies), while the remainder involves costs of site cleanup and damage awards.

Over the medium term, the relative propensity to litigate in the United States will likely hurt the global competitiveness of many export/import-sensitive industries. The allocation of capital to legal activities will divert spending from R&D outlays and other investments that could lower costs and improve productivity. In addition, perceptions by foreigners that this country's business climate is characterized by high legal risks could limit future investment of foreign capital in the United States.

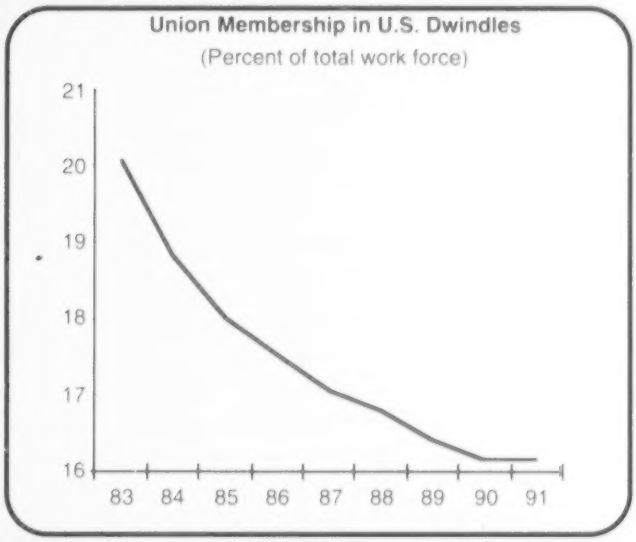
Social Ills Spell Opportunity

Recent attention has been focused on such social ills as urban crime and this country's "sub-standard" education system. Calls for greater spending on crime prevention and education will likely see only limited response given ongoing financial difficulties in the municipal, state, and federal government agencies that provide these services. As a result, more privately owned companies and facilities will emerge to fill this demand. Opportunities in such industries as personal protection, security services, and education services should expand further over the medium term.

Although efforts to reduce pollution and protect the environment and domestic resources will impose additional costs on many industries (and may cause some, such as oil and gas, to shift operations abroad), other industries should benefit. Manufacturers of pollution-control technologies and equipment, environmental engineering and consulting services, and other environmentally focused industries should find opportunities in such a setting.

UNIONS: A Diminishing Role

The potential for a slower rise in unit labor costs and increased productivity in U.S. industry has improved partly as a result of the declining influence of organized labor and the growing efforts of companies to improve employer/worker relations. The failed strike at Caterpillar marked a significant setback for organized labor, which has seen a three-decade-long decline in union membership as a percent of the workforce. Recently, the percentage of unionized workers fell from 20% in 1983 to 16% in 1991.



One reason for the decline in unionization in recent years is that the ability of unions to strike has diminshed. Work stoppages involving 1,000 workers or more declined considerably over the past 11 years from 187 stoppages in 1980 to only 40 in 1991. Work stoppages are likely to remain low in 1992 and 1993 as the failed strike at Caterpillar earlier this year set a new tone for organized labor.

The recent weakness of unions can be attributed to three causes. First, in an economy that has become increasingly global, firms have begun to realize that they can no longer accept union demands and remain competitive in the world market. Unit labor cost, because of its large impact on the price of manufactured goods, is one of the basic determinants of a firm's competitiveness in world trade. Unit labor cost is determined by two factors: employee compensation costs and productivity. Although employee compensation costs have shown smaller increases for union members versus nonunion members over the past decade, various work rules have hampered productivity growth. The process of union bargaining, known as "pattern" bargaining, can also have an effect on productivity. Pattern agreements, which call for similar wage settlements within an industry regardless of divergences in output performance among firms, dampen workers' incentives for increased productivity. Lower productivity, all else equal, raises unit labor costs.

In addition to firms taking a stronger stand against union demands for compensation increases, workers have become increasingly reluctant to strike for fear of lost wages and/or employment. This aspect becomes particularly acute in times of high unemployment. Not only are wages at stake during the strike period, but actual jobs are at higher risk due to a larger number of available "replacement" workers.

The third reason for the decline in unionism is that the "adversarial model" of workers versus management is becoming an anachronism in today's economy. Firms are recognizing the importance of workers' involvement in the entire work process. With a closer alignment of worker and management interests, unions have a more limited role.

Paralleling the general decline in unionization over the past decade has been a significant shift in unionization from the private sector toward the public sector. In 1991, 40% of union workers were employed by government, up significantly from 32% in 1983. While all major private industry sectors experienced declines in their unionization rates from 1983 to 1991—transportation & utilities (42% to 31%), manufacturing (28% to 20%), and construction (28% to 21%)—government remained 37% unionized over this period. As a result, the private sector as a whole experienced a dramatic drop from 16.5% unionization in 1983 to only 11.7% in 1991.

With 16% of its work force unionized, the United States has a relatively low level of unionization compared with other countries. Of the G-7 countries, the U.S. has the lowest unionization rate, with the next lowest being Japan at 25%. Canada's work force is approximately 36% unionized, Germany's 40%, and the United Kingdom's 45%. Correspondingly, the U.S. also had the smallest increase in unit labor costs in the period from 1979 to 1990. Unit labor costs in dollar terms increased at an average annual rate of 2.1% in the U.S., 4.1% in Japan, 5.4% in Canada, 4.5% in Germany, and 3.5% in the United Kingdom. With the smallest rise in unit labor costs, the U.S. continues to hold its competitive position among the world's major economies. Organized labor's declining influence in the U.S. labor market should enhance this position by keeping unit labor costs down.

The downward trend of unionization in the U.S. should continue as labor continues its shift into the traditionally less unionized sectors (*i.e.*, services). In addition, the trend will be away from traditional unions toward more informal associations that can better serve today's worker. Likewise, firms will continue to establish better relationships with their employees by including them in decisions that directly affect them. This trend away from traditional unions and pattern bargaining should help to curb the rise in unit labor costs and increase worker productivity, thereby enhancing American industry's competitiveness in the world economy.

Financial Institutions/Credit

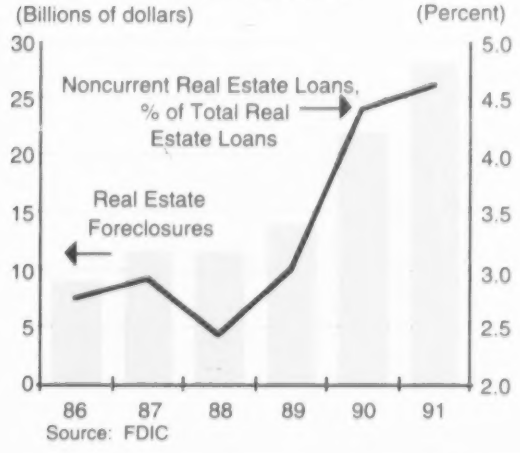
Near Term

Banks Moving Toward More Solid Ground

The banking system in the United States has experienced severe stress with respect to loan quality problems, widespread criticism of creating a "credit crunch," tougher regulatory scrutiny, burdensome reporting requirements, more stringent capital adequacy standards, and dramatically increased deposit insurance costs. Despite these hurdles, the nation's large banks are poised for stronger performance and enhanced efficiency in 1992-93. Disappointment within the financial community with the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) is widespread and represents a serious setback to banks. This legislation, which allowed for recapitalizing the deposit insurance fund, also imposed a voluminous and cumbersome set of new reporting requirements and regulatory constraints on the nation's banks, a move that constitutes a giant step backward.

The prospects for improving the structure of U.S. banking in the near term will depend considerably on the performance of banking institutions this year and in 1993. Banking has already begun a turnaround from a troubled track record in the second half of the 1980s. In 1991, all insured commercial banks recorded total net income of $18.6 billion, a 16% increase over the prior year's earnings. Although this was well shy of the banner year, 1988, when industry earnings hit the $25 billion mark, 1991's performance is likely to be the first of several better years.

Banks Facing Up to Problem Real Estate Loans

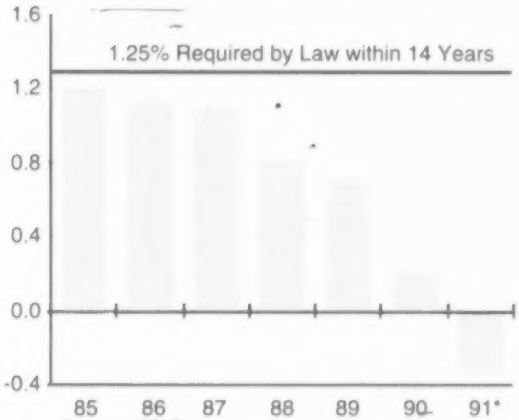


Source: FDIC

Among the impediments to a more solid banking structure in 1992 and 1993, two are especially negative: the level of nonperforming real estate loans and costlier deposit insurance. For all insured banks in the nation, the ratio of noncurrent real estate loans to total real estate loans escalated sharply over the past five years from 2.75% in 1986 to 4.60% in 1991. The 1990-91 recession exacerbated this credit-quality problem, especially in the commercial real estate segment in California and the Northeast. Several of the fifty largest banks are now experiencing some diminution of this problem, but for others, working through bad loans will be lengthy and painful. On the brighter side, bank managements have been adopting a more realistic and forthright policy in resolving their portfolio problems by foreclosing on properties. The value of foreclosed real estate assets on the balance sheets of all banks moved up to $28 billion by yearend 1991, more than triple the 1986 amount.

Bank Insurance Fund in the Red

(Percent of insured deposits, year-end)



Source: FDIC

*Negative ratio in 91 resulted from a $7 billion deficit in the FDIC fund following resolution of failed banks.

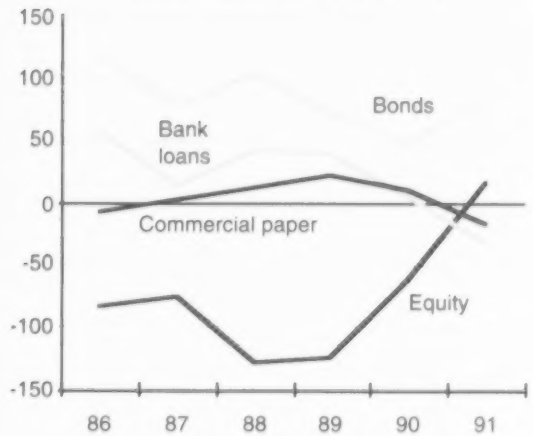
The recent FDIC proposal to raise deposit insurance premiums by an average of 22% and to introduce a multi-tiered, risk-based premium system, effective in 1993, is likely to be adopted. This action would raise the effective cost of funds for banks and potentially squeeze net interest margins of those banks that are highly dependent on core deposits. Consequently, it could accelerate the attrition of the banking industry through failures and/or consolidations. Although the ostensible objectives of the new regulation are to discourage banks from "high" risk-taking and to replenish the FDIC coffers, the unintended consequences are likely to be perverse. The cost of deposit insurance has soared in the past three years and the adjustment for banks will not be easy. From 8.3 cents per $100 of deposits prior to 1990, the premium was raised three times, reaching 23 cents in mid-1991. An increase in January 1993 to 28 cents per $100 of deposits will represent more than a three-fold hike in just three years. Banks that are considered "well-capitalized and healthy" will be subjected to a slightly smaller rise in premiums than those considered "undercapitalized and requiring substantial supervision."

Businesses Shift Financing Patterns

The debt binge of the 1980s left many businesses over-leveraged at the end of the decade. Businesses have strengthened their balance sheets considerably during the last two years. Business borrowing from sources such as banks and the commercial-paper market has declined, while new lower rate corporate bond issues have risen. The heightened activity in new bond issues was in many cases the result of businesses retiring old, more expensive debt, and replacing it with new debt at lower rates, thereby reducing interest expense. More recently, net new issues of corporate stocks have been used to supplement the still-heavy dependence on debt financing.

Equity Financing Resumed in 1991

(Annual flows, billions of dollars)



Households Scale Down Borrowing

Shrinking consumer credit over the past two years indicates a desire for improved household balance sheets as well. With respect to short-term borrowing, consumers have been paying down personal and auto loans faster than they have been adding debt in these areas. However, credit cards and tax-deductible home-equity borrowing remain popular. In addition, many households were able to reduce monthly mortgage payments through refinancing of home loans during the last quarter of 1991 and the first quarter of 1992, thus freeing up enormous amounts of spendable income.

Medium Term

Over the medium term, the American banking system and the nation's financial markets are likely to be transformed in significant ways. Most importantly, nationwide interstate banking and branching will become a reality, in effect canceling the geographical restrictions of the McFadden Act of 1927. This reform measure, scheduled for debate in Congress in the spring of 1993, will allow for economies of scale, diversification of risk across regions of the country, and more efficient transfers of technological innovations and management talent, making large U.S. banks more competitive globally.

"Nonbank" banks are likely to become more powerful competitors, gain a larger market share of the financial services industry, and continue to remain relatively free of the onerous regulatory burdens facing banks and other financial institutions. Foreign banks operating in the United States will grow more slowly in market share and come under more stringent regulation. Expanded powers for banks, such as entry into securities and insurance businesses, will be allowed reservedly by the Federal Reserve, although abolition of the Glass-Steagall Act is unlikely in the medium term.

Demographics and low inflation are two factors which suggest that borrowing in the medium term will grow at a much slower pace than in the 1980s. A large segment of the population, represented by baby-boomers, will exit the peak spending and borrowing years, in which they set up households, and enter years in which they are more likely to save. Low inflation will reduce the incentive for consumers to borrow today's dollars and pay back with tomorrow's cheaper dollars—such as occurs when interest rates do not appear to fully reflect future inflation. During periods of low inflation, households tend to hold assets in financial instruments rather than in tangible investments such as real estate.

The following indicators demonstrate the cautious nature of households in today's recovery compared to behavior in past economic upturns.

Percent change from prior year:	11/71	3/76	11/83	AVG	4/92
Personal Consumption	5.0	6.2	5.1	**5.4**	2.2
Home Sales	22.3	26.6	22.4	**23.8**	7.0
Auto Sales	68.0	34.0	7.3	**36.4**	1.7
Consumer Confidence*	13.3	46.9	26.4	**28.9**	-5.6

*University of Michigan

Consumers are likely to exercise more caution with purchases and choice of loans. However, tax-free home-equity borrowing should remain robust. Credit-card borrowing shows no sign of slowing in the near term, and should remain popular throughout the forecast period. Competition and market forces are already prompting some companies to offer lower rate cards to customers with low-risk credit profiles. Financial institutions will also be responding to a greater focus by households on saving and investment as opposed to borrowing.

Businesses' improved balance sheets will allow for greater capital investment and R&D projects over the medium-term horizon, favorably impacting the competitiveness of U.S. business in the global economy. We expect corporations to maintain healthier debt-to-equity ratios through the mid 1990s than in the 1980s. Small businesses will seek lines of credit from banks, finance companies, and other lending institutions, while larger businesses will continue to use the commercial paper market as an alternative to bank borrowing for short-term funds.

The International Economy

Near Term

Industrial Countries

Japan and Europe both have grown relatively slowly during the past year, but by 1993 a return to more rapid growth is expected. Although Japanese real GDP grew by 4.5% in 1991, most of the growth occurred at the beginning of the year, and by the fourth quarter the economy had stopped expanding. Industrial production has fallen substantially, with this year's first quarter level 4.7% below the same period last year. Earlier restrictive monetary policy designed to contain inflation—especially in asset prices—has brought about the Japanese slowdown. Despite lower interest rates during the second half of 1991, credit expansion has not yet increased. Nevertheless, a gradual recovery in the economy is forecast for this year's second half. By 1993, more vigorous growth in the neighborhood of 3.5% is likely, with inflation remaining near 2%.

Tight monetary policy in Europe has remained the rule, with high real interest rates throughout the continent resulting from the financing of German unification. Despite high interest rates in Germany, money supply growth has exceeded the Bundesbank's target range. In addition, relatively high wage increases have contributed to inflationary pressure. Consumer prices (in western Germany) rose 3.5% in 1991, the most rapid increase since 1982, with a larger rise likely this year.

Because of the exchange rate mechanism of the European Monetary System, the high interest rates in Germany are effectively a floor for interest rates in other countries, some of whose inflation rates are now lower. The resulting high real interest rates mean that real GDP growth this year will generally not be much above last year's low rates. In western Germany itself, output growth should be lower than last year's 3.1% rise, although some revival in the eastern economy will bring about an increase in the all-German figures. By 1993, an easing of monetary policy should bring about stronger economic growth in both regions.

The other continental European economies should grow slightly more rapidly this year than in 1991, as interest rates have fallen in EC countries, except for Germany. Nevertheless, growth will be modest before picking up in 1993. The United Kingdom, which experienced a severe recession, should show slightly positive growth this year before a full recovery is under way in 1993.

Similar to the pattern in the United States, the Canadian economic recovery has remained sluggish. Nevertheless, a combination of lower interest rates, the growing strength of the U.S. economy, and a lower Canadian dollar should give momentum to the recovery in the second half of 1992 and in 1993. During the first quarter of this year, consumer prices in Canada were only 1.6% above their year-earlier level, compared with a 2.9% rise in the United States. Lower inflation in Canada than in the United States should persist during the forecast period.

Developing Countries

Slower economic growth in the industrial countries in 1991 and the resultant slowdown in world trade growth have contributed to rising current-account deficits in a number of developing countries. In many countries, economic growth has either remained at high levels (such as in East Asia) or accelerated (such as in some Latin American countries). This pattern has contributed to relatively rapid import growth at a time when major industrial-country export markets have slowed.

Large deficits have been recorded in such countries as Mexico, South Korea, Thailand, and elsewhere. Nevertheless, economic reforms undertaken during the 1980s have led to environments much more conducive to private capital inflows, and significant proportions of the financing of these deficits have been provided by foreign direct investment and by investment in local stock markets.

INDUSTRIAL COUNTRY INDICATORS

	Real Economic Growth (GDP, annual average % change)				Inflation (CPI, annual average % change)			
	1991	1992e	1993f	1994-97f*	1991	1992e	1993f	1994-97f*
Japan	4.4	1.8	3.2	4.4	3.3	2.1	2.3	2.5
Germany**	0.0	1.5	3.5	3.2	3.5	4.0	3.6	2.6
France	1.2	1.8	2.8	2.4	3.1	2.9	2.7	2.6
Italy	1.2	1.4	2.5	2.7	6.4	5.4	4.9	4.2
United Kingdom	-2.1	0.8	2.8	2.6	5.9	3.9	3.0	2.9
Canada	-1.5	1.5	3.1	2.9	5.6	1.9	2.5	2.8
Total of above countries	1.6	1.6	3.1	3.4	4.1	3.2	3.0	2.8
Total G-7 (Above + U.S.)	0.7	2.1	3.2	3.0	4.2	2.9	3.1	3.3

* Average annual rate of change, 1994-1997

** Real GDP for Unified Germany; CPI for western Germany only

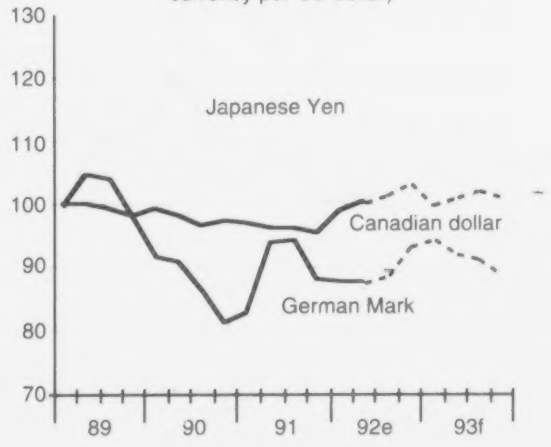
This is in contrast to the pattern of earlier years, when government borrowing from commercial banks or from official multilateral institutions provided a much higher proportion of financing. In general, the shift away from debt toward equity financing should be considered a healthy development. While the debt positions of these countries are now generally manageable, continuation of private capital inflows is dependent on the maintenance of investor confidence.

Dollar Rebound Likely

During the first four months of 1992, the dollar strengthened markedly against the yen, the deutschemark, and the Canadian dollar. In May, however, the U.S. currency reversed itself against the yen and the deutschemark as market participants appeared to lose confidence in the strength of the U.S. recovery and to focus on uncertainties in the U.S. political outlook. Lower U.S. interest rates also played a role in the dollar's drop. In the case of Canada, however, easing by the Bank of Canada meant that the U.S. dollar maintained its strength.

Despite the dollar's drop in May, it was still above its yearend 1991 level *vis-à-vis* the Japanese, German, and Canadian currencies. Our forecast for the U.S. economy—characterized by a rising interest-rate environment and a strengthening of both real economic growth and corporate profitability—favors a rise in the dollar during the remainder of this year.

Dollar to Rise Modestly in 1992
(Quarterly index, 1989 QI = 100; foreign currency per US dollar)



In addition, Japanese interest rates are expected to remain low, while the economy on average will grow more slowly. In Germany, further interest rate rises are not expected, and by the end of the year some easing by the Bundesbank may occur. While these factors are all generally pro-dollar, political uncertainty in the United States could prevent the dollar from rising as much as it might otherwise prior to the presidential elections. In the fourth quarter of 1992, the yen could fall to the neighborhood of $1=¥137 before gradually strengthening during 1993, while the low point of the deutschemark might be about $1=DM1.75. The Canadian currency, which has weakened considerably against the U.S. dollar from the highs recorded late last year, may remain in the range of C$1=US$0.81-0.84 during the period between now and the end of 1993.

Current-Account Deficit Rising Again

Due to a one-time event—the Gulf War—the U.S. current-account deficit was almost eliminated in 1991, falling to only $8.6 billion from $92.1 billion the previous year. Last year's deficit was the lowest since 1982. A shift in the "official transfers" balance from a deficit of $17.5 billion in 1990 to a surplus of $25.1 billion in 1991 was the result of payments made by allied nations to the U.S. government.

U.S. CURRENT ACCOUNT
(Billions of U.S. dollars)

	1989	1990	1991	1992e	1993f
Trade balance	-115.9	-108.1	-73.6	-77.6	-89.4
Exports	361.5	389.6	416.5	444.4	482.2
Imports	-447.4	-497.7	-490.1	-522.0	-571.6
Service balance	22.4	26.4	35.9	36.8	37.7
Service exports	116.5	133.3	144.7	154.8	168.7
Service imports	-94.1	-106.9	-108.8	-118.0	-131.0
Income balance	2.7	11.9	9.4	9.5	6.6
Income: credit	128.7	130.1	115.3	111.2	123.0
Income: debit	-126.0	-118.1	-105.9	-101.7	-116.4
Transfers balance	-15.5	-22.3	19.7	-22.7	-24.5
Official	-11.1	-17.5	25.1	-16.8	-18.0
Private	-4.4	-4.8	-5.4	-5.9	-6.5
Current-account balance	-106.3	-92.1	-8.6	-54.0	-69.9

Although the shift in the transfers balance was the largest reason for the drop in the current-account deficit, the merchandise trade deficit also dropped significantly, reaching $74 billion from levels of over $100 billion in each of the previous seven years. The lower trade deficit was brought about by a combination of a drop in imports because of the U.S. recession and fairly strong export growth to markets in Latin America and East Asia.

In 1992, the trade deficit is forecast to rise modestly as import growth revives, and a further increase is forecast for 1993. As a result of this rise and the return to deficit in the "official transfers" account, the current-account deficit is forecast to rise in both years, reaching about $70 billion in 1993. This level will be below the annual deficits recorded during the second half of the 1980s.

Medium Term

Several issues that will affect the medium-term outlook for the global economy and international trade are highlighted in the following discussion. In general, real GDP growth in the G-7 countries outside

the United States should accelerate from its low point in 1992, while inflation will remain subdued.

Economic Integration

The process of establishing a Single European Market is well advanced. During the next few years, companies and financial institutions will continue the process of adjusting to the removal of national barriers among European Community (EC) member countries. In addition, the possibility of monetary unification by the end of the decade is already putting pressure on governments and central banks to reduce budget deficits and maintain anti-inflationary monetary policies. In a few instances, budget-deficit targets may be difficult to attain, although a low inflation environment in the large countries now looks likely over the medium term. As it now stands, the United States may have the highest inflation in the G-7 countries during the 1994-97 period, with the possible exception of Italy.

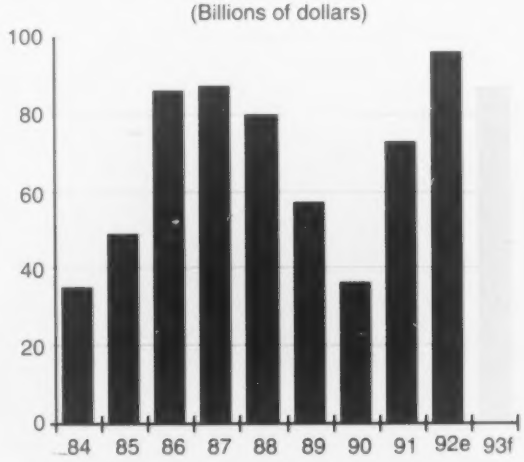
Economic integration elsewhere is becoming increasingly common. It is very possible that Mexico will join the United States and Canada in forming a North American Free Trade Area in 1993. In addition, several groupings of Latin American economies are in the process of closer integration, while the Association of Southeast Asian Nations (ASEAN) has announced its intention to lower further barriers to internal trade.

The move toward economic integration has implications for trade and investment flows. In general, larger economic groupings will make it easier for manufacturing firms that invest abroad to take advantage of economies of scale. Thus, foreign direct investment should be stimulated as a result of the trend toward integration.

Return of Large Japanese Surpluses

A return to larger Japanese trade and current-account surpluses is occurring in 1992. For the year as a whole, a rise in the current-account surplus to nearly $100 billion is forecast. At this level, the dollar value of the surplus would be larger than ever recorded by any country. Relative to the size of the economy, however, it would not be as large as some Japanese surpluses of the past or of surpluses recorded by some other countries. Only a slight decline in the surplus is forecast in 1993, and a medium-term question is whether this surplus will remain relatively large for some years to come. If it does, it could exacerbate trade tensions between Japan and its major trading partners, tensions that have been fairly high in the recent past. Another implication of a return to large surpluses is that Japanese investment will once again be a major part of global capital flows. Much of this investment now appears to be focused in Asia, and greater integration of the capital markets of this region could result. It seems likely at present that a smaller proportion of Japanese investment will be made in the United States.

Large Japanese Current-Account Surpluses Return
(Billions of dollars)



Emergence of New Markets

Although considerable risks remain, over the medium term it is likely that the integration of not only Eastern Europe but also Russia and the Central Asian republics into the global market system will be a stimulus to international economic growth. This could occur after a further period of economic decline in the coming year or two, as these economies adjust to international competition. All these countries have now joined the IMF and the World Bank, which are the major multilateral financial organizations.

Political obstacles in the path of the transition toward market economic systems remain formidable. It is virtually certain that setbacks will occur. However, the level of financial support available both multilaterally and bilaterally indicates that the volume of trade with these countries is very likely to increase, an additional factor in the growth of international trade in the 1990s.

Latin American Re-Emergence

Yet another stimulative factor in the medium-term outlook is the re-emergence of Latin American countries following a decade that saw their shares of world trade and economic output decline. Although some reversals have occurred in the past six months, the overall trend toward economic liberalization is clear. Already, Mexico has become an important and rapidly growing market for U.S. exporters, and export prospects in other Latin American markets are also improving. By the middle of the decade, most of the countries of the region should be on the path of more rapid economic growth and expansion of international trade and investment relations.

FI Territory

First Interstate currently owns affiliate banks in thirteen states in the western part of the U.S. and Texas. With the exception of California (see *California Edition* for greater detail), all of the states in First Interstate Territory outperformed the country as a whole in 1991. During 1992, California will record another decline in average employment for the year. All of the other states in the First Interstate region will record positive job growth at rates above the national average. Over the five years beginning in 1993, each of the states in the Territory will nearly match or surpass job growth in the nation, except Alaska and Wyoming. The fastest job growth is projected for Nevada and Arizona.

Near Term

California—Trying to Recover

California's economy has been hammered hard during the past two years by its close linkage to the national economy, as well as by the impact of defense cuts and the negative image of its business climate. A number of natural and man-made disasters have compounded the state's economic difficulties. The state's economy appears to be stabilizing, however, and is expected to begin an upturn later this summer. The southern part of the state will trail the northern half by four to six months in the recovery phase. Nonfarm payroll employment in California will still be down an average of about 0.4% this year, following last year's sharp drop of 2.6%. Job growth should improve in 1993, with a gain of 2.1%, although this will still be below the forecast for the nation.

Northwest—Slightly Less Dynamic

The Northwest Region outperformed the national economy in recent years, but growth has now slowed. The aircraft industry—Boeing and its suppliers—is trimming its workforce due to defense cutbacks, reduced production levels, and productivity improvements. This will not push Washington into recession, but it will put a brake on the state's growth. Smaller aerospace job reductions will take place in the coming years, but a downturn will be avoided as worldwide economic growth stimulates travel.

The wood products industry has already seen most of its decline, caused by the recession and environmental limitations. Demand for wood is improving, but environmental issues preclude any significant increase in the timber harvest and, thus, in lumber and plywood processing.

The food processing industry is looking forward to increased exports, especially to lesser developed and former communist countries. In addition, the high-technology sector will benefit from stronger capital spending anticipated for the nation. The Northwest urban centers also have large numbers of manufacturers which do not fit into the major categories shown in government reports. When all of the "miscellaneous and other" firms are added together, they make a formidable manufacturing base, which should expand with the national economy.

Aerospace cutbacks in Washington will offset other sources of increase to allow the state to post a job gain of only 0.9% in 1992 before growth improves to 2.8% in 1993. After a small job loss in 1991 (0.1%), Oregon's economy is expected to realize sizable employment growth of about 2% this year, followed by 3% in 1993. Population increases, with sizable numbers of new residents from California, continue to be a major source of support for the economy. Tourism and electronics will also be important.

Because Alaska's economy shows little relation to national swings, the state registered a job gain of over 2% last year, despite the U.S. recession. More modest gains averaging about 1.5% a year are forecast for the 1992-93 period.

Idaho is currently the fastest growing state in the nation and we anticipate only a moderate slowing over the next two years. Employment is expected to repeat last year's 3.6% expansion in 1992, followed by a gain of 3.0% in 1993. Montana's economy showed job gains last year, but we expect employment growth to approximately double to 2.2% in 1992-93.

Southwest—Poised for an Upturn

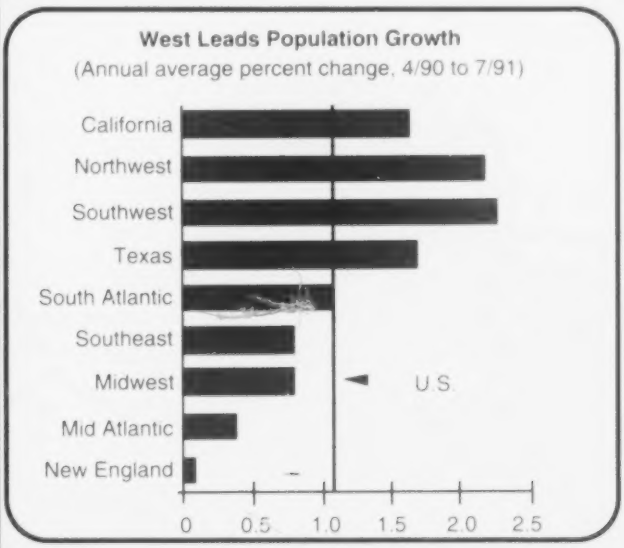
First Interstate's Southwest Region endured the brunt of the commercial real estate slump that plagued many areas of the nation in recent years and managed to weather widespread defense spending cuts relatively well. Most of the six states reached the bottom of their respective economic cycles during 1991 and are now poised to achieve better results.

Arizona's extraordinary growth in the 1980s made it the most populous state in the Southwest region. Strong migration flows persisted even after the state's job market faltered during the recession. The climate and amenities that have traditionally attracted retirees to Arizona will continue to support population and associated job growth.

Colorado's economy is rebounding admirably from a period of weakness that had its roots in the mid-1980s energy bust and was prolonged by overly aggressive commercial real estate development. The state enjoyed relatively robust job creation during the nation's recession, and most segments of the real estate market have started to improve. Colorado had a net gain of more than 30,000 migrants from other states in 1991, breaking a five-year trend of net outmigration. A series of major public works projects, including the Denver regional airport, a major league baseball stadium, and new highway construction, have made significant contributions to the economy's renewed vitality.

WEST WINS POPULATION GAINS IN THE 1990s

During the latter half of the 1980s, western states enjoyed the benefits of a higher growth rate in population than the rest of the nation. Census numbers showed that between 1980 and 1990, while the U.S. population grew by an average annual rate of 0.9%, growth in First Interstate's 13-state Territory was 2.0% per year, twice as high as that of the nation.



In recent years, Oregon, Washington, and Idaho have experienced significant amounts of in-migration from other states. This trend shows no sign of slowing. The Northwest continues to offer a "better" lifestyle to people who have become disillusioned with areas such as New England or California, where the recession hit particularly hard. Between April 1990 and July 1991, the Northwest grew at an average annual rate of 2.2%, more than twice the rate of growth in the nation.

In-migration in the Southwest has also been strong, particularly in Nevada, Arizona, and Utah. Between 1990 and 1991, Nevada's population grew at an average annual rate of 5.3% (compared to less than 1% for the U.S.), making it the fastest growing state in the nation. Because of its tax structure and strategic location, Nevada has become an attractive location for businesses and households seeking to relocate from states with higher population density and living costs.

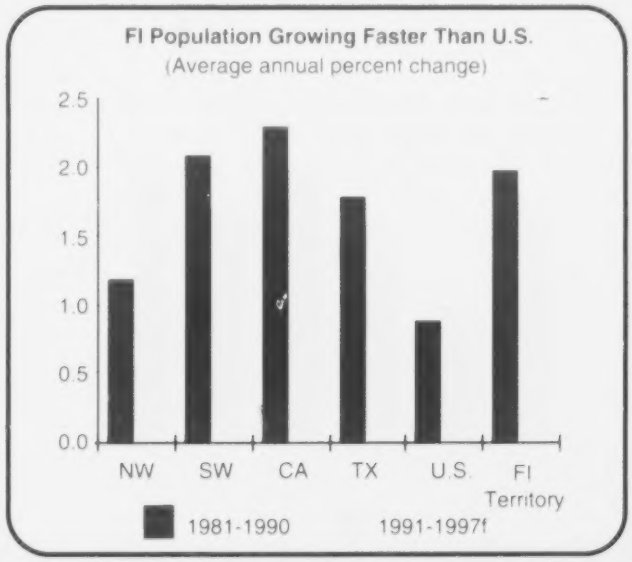
In contrast to its neighbors, California's current growth can be attributed almost exclusively to foreign immigration and natural increase. Indications are that net migration from other states into California will be zero this year. California has lagged the nation in beginning an economic turnaround. Losses of jobs in the defense and service sectors continue to impact the state. In spite of California's problems, however, its population continues to grow at annual rates that surpass overall growth in the U.S.

Texas has continued its recovery from the deep downturn of the mid 1980s. Population is growing once again from both in-migration and foreign immigration, as well as from a natural increase.

Over the medium term, the population will continue to shift towards the West, as people migrate in search of greater economic opportunity, enhanced quality of life, and better climate.

Demographic and social trends that held down household incomes in the 1980s will shift in the 1990s, producing an overall rise in family incomes as the baby-boom "bulge" continues to exercise its influence. In contrast with the 1980s, when many households were headed by individuals in their thirties, households in the '90s will be headed by individuals in the 35-to-55 age bracket, typically the peak earning years. These households will be more inclined to save than to spend, as they face the prospect of financing college education for their children, elder care for their parents, and their own retirement.

With international barriers tumbling around the world, immigration will continue to be a vital force for economic change over the medium term. Increasingly, however, jobs require more technical skill and education than many immigrants or current residents possess. While competition for low-skilled jobs may be a real concern, education of the work-force will be an even greater challenge. Today's trend toward corporate involvement in education of workers is likely to grow.



Our forecast is for population growth to settle over the medium term at around 1% for the nation. However, First Interstate Territory population growth is forecast at an average annual rate of 1.8%. Western states will continue to enjoy growth in jobs and income as a result of this trend.

Nevada, which led the United States in employment and population growth in recent years, endured a sharp commercial real estate downturn in 1990 and 1991. The tourism-related hotel, convention and gaming sectors bounced back in early 1992, and a new wave of hotel development in the Las Vegas area promises to boost construction activity over the next two years.

New Mexico is projected to have moderate economic growth similar to the national average in the near term. New Mexico's economy was relatively stable in 1991, managing a gain of only 0.5%.

Wyoming's 6.8% growth in personal income in 1991 led the nation, a rare distinction for a state that suffered disproportionately from the abrupt end of the energy boom several years ago. The outlook suggests that the state's population, declining in recent years, will post small increases as the economy stabilizes and completes its adjustment to lower energy prices.

Texas—Renewed Expansion

Texas has not escaped the impact of the latest recession and defense reductions, but the state managed to register job growth of nearly one percent in 1991, in contrast to a job loss of over one percent at the national level. The state has experienced job reductions in aerospace this year, along with employment cutbacks in the oil and gas sector. Job gains are taking place, however, in the petrochemicals industry, as well as in other segments of nondurable goods manufacturing, including apparel, paper, and printing. Above-average population growth is also supporting job gains in retail trade, government, and various services. On balance, we expect total employment in Texas to be up about 1.7% this year and 2.9% in 1993—gains representing an average 0.8 percentage point margin over the nation.

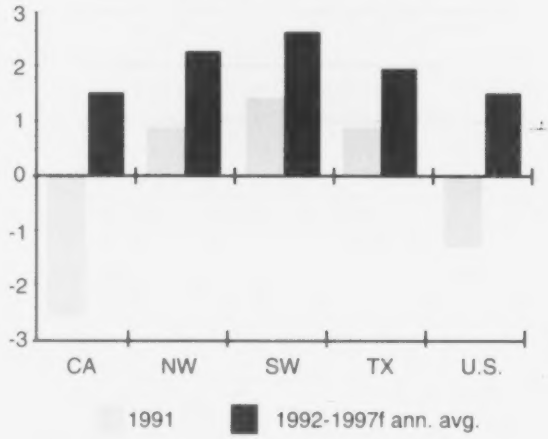
Home sales, prices, and construction continue to generally improve in Texas. Relatively good absorption of office and other commercial space is helping to gradually whittle down vacancy rates in such markets as Houston.

Medium Term

California's economy should again grow slightly faster than the nation beginning in 1994, although the state will just be regaining the employment level reached in 1990. The state will continue expanding faster than the country as a whole through 1997, and population growth will be about twice the national average. California will undergo some major structural adjustments over the next five years, as agriculture, construction, and manufacturing are likely to be slightly less important as a share of the economy. Various service and research industries are likely to become more significant. These include design, environmental engineering, software, biotechnology, entertainment, tourism, and health care. California is expected to remain a focal point for entrepreneurship and innovation, while international trade becomes even more important.

FI Regions Generally Outperform Nation

(Percent change in nonfarm employment)



The Southwest will continue to absorb its excess commercial space. Colorado will experience some slowdown in construction after some of the major public works projects currently under way are completed. Nevada is also likely to see more moderate growth when the current boom of new hotel construction ends. Both states, however, will see significant offsetting job gains in other sectors. In the five years ending in 1997, Nevada and Arizona will register average increases in employment nearly twice the national trend, with Utah not far behind.

Over the longer term, we expect the Northwest Region to outperform the national economy, as inmigration, one of the region's current strengths, continues to stimulate the economy. Migration into the region fuels labor supply, which puts downward pressure on wage rates, helping local firms expand. In addition, the larger population causes higher demand for services such as health care and housing, which in turn, stimulates employment. In short, if people want to come, the jobs will follow.

Texas will diversify further from its dependence on oil and gas exploration and development, although the energy sector will remain important to the economy. The state will grow moderately faster than the nation each year in the forecast period and will develop further as a major regional headquarters for various corporations. Defense cutbacks will continue to affect the manufacturing sector, but home construction should continue to grow with a rising population. Increased trade and investment ties with Mexico will also bolster the border areas of the state.

NONFARM PAYROLL EMPLOYMENT

	1991		1992e		1993f		Average annual
	Thousands	% Change	Thousands	% Change	Thousands	% Change	% Change 1994-97 f
California	12,497	-2.6	12,442	-0.4	12,698	2.1	1.9
Northwest	4,364	0.9	4,432	1.6	4,554	2.8	2.5
Alaska	243	2.1	246	1.4	250	1.6	1.1
Idaho	399	3.6	413	3.6	425	3.0	2.1
Montana	301	1.2	308	2.4	314	2.0	1.3
Oregon	1,251	-0.1	1,274	1.9	1,313	3.0	2.5
Washington	2,171	0.9	2,190	0.9	2,252	2.8	2.8
Southwest	5,203	1.4	5,346	2.7	5,526	3.4	2.5
Arizona	1,498	0.8	1,538	2.7	1,592	3.5	3.0
Colorado	1,542	1.4	1,585	2.8	1,635	3.2	2.4
Nevada	632	1.9	654	3.4	681	4.1	3.1
New Mexico	583	0.5	591	1.3	606	2.5	1.4
Utah	745	3.0	772	3.6	802	3.9	2.7
Wyoming	203	2.1	206	1.7	210	1.9	1.2
Texas	7,167	0.9	7,289	1.7	7,500	2.9	1.9
FI Territory	29,232	-0.5	29,509	0.9	30,279	2.6	2.1
U.S.	108,310	-1.3	108,852	0.5	111,532	2.5	1.4

PERSONAL INCOME

	1991		1992e		1993f		Average annual
	$ Billions	% Change	$ Billions	% Change	$ Billions	% Change	% Change 1994-97 f
California	631.4	1.9	652.9	3.4	692.7	6.1	5.9
Northwest	190.4	5.3	201.0	5.5	214.3	6.6	6.3
Alaska	12.5	4.8	13.1	4.8	13.8	5.4	4.4
Idaho	16.0	3.8	17.2	7.3	18.4	6.9	6.1
Montana	13.0	6.0	13.8	6.4	14.6	5.9	4.6
Oregon	51.4	4.6	54.5	6.0	58.4	7.2	6.5
Washington	97.6	5.8	102.4	5.0	109.1	6.5	6.7
Southwest	208.3	5.3	221.3	6.2	236.9	7.0	6.3
Arizona	61.5	4.4	65.2	6.0	69.8	7.1	6.5
Colorado	65.6	5.3	69.8	6.4	74.7	7.0	6.2
Nevada	24.6	5.1	26.3	6.9	28.3	7.6	7.0
New Mexico	23.0	6.0	24.2	5.2	25.7	6.2	5.6
Utah	25.7	6.2	27.5	7.0	29.6	7.6	6.7
Wyoming	7.9	6.8	8.3	5.1	8.8	6.0	5.0
Texas	300.2	5.3	316.4	5.4	338.6	7.0	5.8
FI Territory	1,330.4	3.6	1,391.6	4.6	1,482.5	6.5	6.0
U.S.	4,812.1	3.2	5,043.3	4.8	5,377.7	6.6	5.4

Note: Calculations based on unrounded data.
Data based on sources currently available, subject to sizable revisions.